U.S. POLICY TOWARD INTERNATIONAL INVESTMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

JULY 30, SEPTEMBER 28 AND OCTOBER 28, 1981

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U.S. POLICY TOWARD INTERNATIONAL INVESTMENT

THURSDAY, JULY 30, 1981

United States Senate,
Subcommittee on International Economic Policy
of the Committee on Foreign Relations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:21 a.m., in room 4221, Dirksen Senate Office Building, Hon. Charles McC. Mathias (chairman of the subcommittee) presiding.

Present: Senators Mathias, Tsongas, and Dodd.

The Chairman. The subcommittee will come to order.

The Chair wants to extend his apologies to the witnesses and others in the room for being a little late.

I had several earlier appointments that did not conclude at the time they were supposed to.

The Subcommittee on International Economic Policy today is holding oversight hearings which are the first in a series on U.S. policy toward international investment. By "international investment" we intend to comprehend both inward investment and outward investment.

The hearing today will focus on "performance requirements," the local content and minimum export requirements imposed by foreign governments on U.S. businesses that are investing abroad.

We are fortunate to have with us today a distinguished panel. I would announce that those who will be testifying are: Mr. Rowland H. Thomas, Jr., on behalf of the American Electronics Association; Mr. Alan W. Wolff, on behalf of the Labor Industry Coalition for International Trade; and Mr. C. Fred Bergsten, of the Carnegie Endowment for International Peace.

Gentlemen, how would you like to proceed?

[Pause].

The Chairman. Before you do proceed, gentlemen, let me announce that we are also glad to have with us Mr. Brian Turner of the Industrial Union Department of the AFL–CIO and Mr. Allan Cors of Corning Glass Works, both veterans of Capitol Hill. I hope they will feel free to take part in our discussion.

Fred, why don't you lead off.

STATEMENT OF C. FRED BERGSTEN, SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

Mr. Bergsten. I would be glad to begin, Mr. Chairman.

What I tried to do in my statement this morning is three things: To state briefly where we stand in terms of U.S. international investment

policy and why we got there; second, to identify a series of major new problems that have arisen for international investment and international investment policy throughout the world; and, third, to give some ideas on what to do about it and how.

I will briefly recapitulate, at the start, the very sizable role that international direct investment plays in the world economy. The book value of U.S. foreign investments now exceeds $200 billion. The total assets of the foreign affiliates of U.S. firms, already 4 years ago, exceeded half a trillion dollars. The annual production by multinational firms probably approaches $2 trillion, which is something like one-sixth the gross world product, and is about equal to the level of international trade.

So we here are talking about very substantial amounts, even relative to the U.S. economy and as a share of the world economy itself.

One might therefore say that it is quite surprising that we have gotten this far in terms of investment magnitudes and in terms of post-war international economic cooperation without having either any international rules of the game or institutional arrangements relating to international investment or to any more explicit U.S. policy than has developed up to this time.

U.S. policy, as you know, is basically one of an open door. We encourage both outward and inward foreign direct investment on the traditional view, which I think is right and which has served U.S. interests well, that such investment contributes to efficient world output, serves our own economy, and serves our foreign policy interests as well.

But I think a number of new developments are occurring that do begin to raise questions about current U.S. policy as to whether it is adequate in addressing those developments.

The basic problem is that host countries to foreign direct investment—those countries which receive such investment—are increasingly active in manipulating the investment flows to promote their national economic, social, and political interests.

Traditional economic theory and traditional U.S. policy has assumed that investment responds primarily, if not solely, to market forces and thus increases economic welfare all around.

Now, however, the governments of host countries have become exceedingly active actors in the international investment area. Their objective is simple: to maximize the flow of foreign investment into their economies on terms which are supportive of their national economic and social goals.

Very few host countries any more ask the simplistic question: do we want or do we not want foreign investment? Nor, in fact, is nationalization or ownership usually the question, because host countries have learned that ownership does not assure control and that control does not require ownership.

Indeed, host countries now ask primarily how they can channel foreign investment to their national purposes and how to attract investments of the type that will do so.

Host countries—both industrialized host countries and developing host countries—use numerous specific methods to achieve those purposes, but I think one can group them under the two topics which you, Mr. Chairman, highlighted for discussion this morning. The first is incentives.

Most host countries offer numerous tax, credit, and other incentives to attract investment from abroad. Subsidy shopping, as it is called, is a common practice of multinational firms, particularly those which are footloose in the sense that they can set up a particular production line in a wide variety of geographic locations.

The results of these investment incentives, sometimes offered only to foreign investors, is to shift production—this means jobs, technology, exports, currency strength, et cetera—from the home country, where the firm is based—and that still is largely the United States—to the host country, and to do so on a noneconomic basis; because, to the extent the investment is motivated solely or primarily by the incentive rather than the underlying economics, it is noneconomic, it distorts economic relationships, and it shifts the benefits of production from home country to host country.

I would argue that such incentives are also of dubious value to the host countries themselves. These entities wind up emulating each other to a large extent. If country A does it, then country B feels he has to compete with A and therefore puts in a similar type of incentive. One study that was done a couple of years ago of 41 developing countries, which are active in their involvement in international investment, showed that 38 of them extended incentives of this type—not always identical, but of a similar variety and magnitude.

So, in essence, they wind up emulating each other and transferring revenues from their own, often poorer treasuries to the firms themselves and to the treasuries of the home countries.

Now, it is not only foreign countries that do this. As we all know, U.S. States do it to some extent. I had some discussions with them about it while I was in Government recently. One of them commented that "we are wasting $5 billion a year in the business of offering incentives." We wind up copying each other, there is no net effect, but we waste money in the process.

So, the effect can be that an individual host country winds up not terribly benefitting vis-a-vis another host country, but as a group they wind up offering incentives which deflect investment from a home country, such as the United States, to countries abroad, and shift production.

I would argue that it is desirable for both home and host countries to find a way out of this incentive business and to do it fast because it clearly is proliferating.

The second set of measures that countries undertake can be labeled "performance requirements."

To make sure that the investments promote host country objectives, the host countries usually insist on a wide array of commitments from the firm to certain performance objectives—minimum levels of job creation; minimum export levels or some share of production that is exported; local value added or content requirements; specified amounts of technology or capital transfer. Only firms which commit themselves to such results through whatever official agency the host country has in place are permitted to proceed with their investments. The results, of course, may be adverse to the economic interests of the home country, again, most frequently the United States. The results can be a mandated shift of technology.

Senator TSONGAS. May I interrupt?

Since there are only three Senators here and since we have a small panel, I wonder whether we could ask questions of the witnesses as they go along?

The CHAIRMAN. Will that be disruptive to your presentation?

Mr. BERGSTEN. Oh, no. Please break in at any point.

Senator TSONGAS. Well, I should have broken in earlier, at the point at which my question occurred.

You suggested if a company goes into a particular developing nation based on incentives, that would not be pursuing traditional economic theory. Why would not the incentives provide an economic basis for decision where to go?

Mr. BERGSTEN. I am assuming that the investment would not take place in the absence of the incentive. Therefore, the investment does take place only in response to what amounts to a subsidy of one type or another. The country puts the subsidy in place to get production or to get a particular industry that would not occur otherwise. Therefore, almost by definition, this is not economic.

Senator TSONGAS. In a situation where a company decides it is going to go and build product X in one of these 10 countries and within the 10 it decides where to go based on incentives, that surely is an economic decision.

Mr. BERGSTEN. Well, it may be that a U.S. company decides to invest abroad and then it shops around for where to invest abroad. Suppose Spain gives a big incentive. It may then wind up that the company invests in Spain rather than in France.

Now this may not be a big problem for the United States since the company was going to invest abroad anyway, but it is a problem for France. There is bound to be an international repercussion of that kind of activity.

Senator TSONGAS. I have no problem with that. But the decision as to where to locate was an economic decision.

Mr. BERGSTEN. It may have been. I think I was careful to say "may." I would not indict on a blanket basis all incentives of this type. One has to be careful.

When a country reduces the tax level in general, as just has been done here, or takes other steps that provide incentives to investment in general, then no indictment should be levied. Particularly when they are tailor made to specific investments of this subsidy-shopping nature, however, which has been very prevalent in recent years, then I think you have a problem of the type that I indicated.

Let me wind up my comment on what host countries do by saying that they usually combine these two sets of measures, the incentives and the performance requirements. It really is a carrot and stick approach. They use the incentive programs frequently to induce the firm to come in in the first place and to do those things which frequently are uneconomic in order to meet the performance requirements. In essence, a bargaining process is created; both sides probe for maximum advantage until a deal acceptable to both is struck; and the result may frequently be an alliance, if an uneasy one, in some cases, between the firms and the governments of the host countries, with possible detriment—and this is the policy point—with possible detriment to the economic interests of the home countries, notably the United States.

In fact, I think it is ironic that such negotiations, which are increasingly determining the location of world production, take place between two actors: the private firms and the governments of the host countries. There is nobody in that negotiation who defends the national interests of the home country, neither the government of the home country nor anybody else. It is a rather one-sided, or two-sided, negotiation in an operation where there are three very important interests at stake.

There are a number of specific examples of these performance requirements which are laid out very nicely in the LICIT [Labor-Industry Coalition for International Trade] study earlier this year, and I am sure that Alan Wolff and others will comment on them, so I will not spend any time on them in my oral presentation. I will simply say that a number of these requirements do violate the existing trade rules and ought to be attacked under those rules.

However, there are a number of these investment requirements which I think cannot effectively be caught under the existing international rules of the game, the trade or other rules. I will give one example: Minimum local content or value added requirements.

If a host country requires the automobile industry in its country to produce 100 percent of the value added domestically, that is equivalent to a zero import quota on components or other inputs. I think we will hear that in the computer industry there are very real examples of that happening today. However, because the country does it through an investment regulation, rather than an import quota, it is not caught under the existing GATT [General Agreement on Tariffs and Trade] or any other trade rules. This, in a nutshell, is why we need new international rules governing the investment process if we are to deal effectively with this kind of problem.

There is one other new development worth mentioning before I turn to suggested remedies. This is the very rapid increase in foreign direct investment coming into the United States.

Over the past 5 years, the book value of foreign direct investment in the United States more than doubled, whereas outgoing foreign investment by U.S. firms rose by only 50 percent. The letter is still rising and is still much bigger in absolute terms, but is not growing nearly as rapidly as incoming foreign investment.

Senator TSONGAS. Is that change a function of OPEC [Organization of Petroleum Exporting Countries] investments?

Mr. BERGSTEN. No. I think OPEC accounts for less than one-half of 1 percent of the book value of foreign direct investment in this country. Most OPEC investment here is in very short-term liquid form, such as Treasury bills and bank deposits. The published data show that OPEC holdings of direct investment are less than one-half of 1 percent.

Now, to the extent they came through a Swiss nominee or some indirect route, the number might be a little higher. But it is clearly a miniscule share of the total and, in fact, is consistent with their preferences, which are to have most of their investments in short-term, highly liquid form.

OPEC is not a major factor. It is the European countries and Canada primarily that are accounting for this big increase in U.S. investment.

The CHAIRMAN. That's not very much recycling, is it?

Mr. BERGSTEN. There is not much long-term recycling of a direct investment nature, that is right.

The OPEC investment portfolio is moving out a bit in maturity in holdings of Treasury bonds and notes, but not at all significantly in direct investment.

Most of the direct investment coming in here is attracted by market forces, including broad political considerations.

Our Federal Government offers very few inducements of the type I have been talking about that other countries do, although some of our State and local governments do offer incentives somewhat similar to those offered by national governments in other countries.

A key point, though, is that the United States is almost alone among host countries in avoiding any effort to control or even to direct the inflow of incoming investments. No performance requirements are applied; no registration, let alone negotiation, is required of foreign firms. The United States is clearly the most open market in the world for foreign investors.

I hasten to say that I believe this policy is right and is strongly supportive of U.S. interests; but it does differ markedly from that of trends in the rest of the world at this time, and therein, I think, lies an important issue.

Now, what should we do about this?

From the standpoint of the United States there are therefore two dominant trends in international direct investment relationships as far ahead as I can see. First is increasing manipulation by other host countries of direct investments from the United States and other home countries; second is increasing foreign investment in the United States by firms from other nations, often the same nations whose governments are manipulating U.S. investment when the roles of home and host are reversed.

I think, largely as a result of these developments, you now have before you in the Congress a spate of proposals to reverse, or at least to modify, the traditional open policy of the United States toward incoming investment, or at least to insist on reciprocal treatment for U.S. investors abroad, either by liberalization abroad or by tightening at home.

The convergence of these forces suggests to me the possibility of a new strategy for U.S. international investment policy: a major multilateral effort to develop what I would call a "GATT for investment"; a new set of international rules and institutional arrangements to protect the open flow of international investment; with the inevitable possibility in the absence of such steps of unilateral U.S. measures to protect U.S. interests more directly, promoting international interests in negotiating such an international arrangement.

It seems to me that the basic objective of U.S. international investment policy should be to limit and eventually to eliminate manipulations of international investment flows by all governments, particularly these incentives and performance requirements.

It seems to me that over the long run there is only one effective way to achieve this goal. We cannot do it unilaterally. The only effective way is to negotiate a new international GATT for investment which would seek to keep Governments' hands off the international investment process, the same way that the GATT itself has sought,

without perfection but with a lot of success, to keep Governments' hands off international trade flows.

Senator DODD. If I might interrupt you there, would you exclude any kind of bilateral efforts? We have some tax treaties coming before the committee with individual countries. One in particular is the Morocco Tax Treaty, and there is some talk about adding provisions that would give a tax credit on forced loans to U.S. companies doing business in Morocco. Is that the kind of thing you would exclude?

Mr. BERGSTEN. No, not at all. I think bilateral efforts are useful in a number of areas, particularly the tax area. There also is a new approach being pursued by a number of other countries and now being thought of seriously here in the United States, called bilateral investment treaties, where you would go out bilaterally with a developing country, particularly, and try to negotiate rules of the game for U.S. investment in those countries.

I think those can be used effectively. In fact, we tried to do so in the last administration in at least one case, to make a dent, at least, in these host countries' uses of performance requirements and incentives. But one would have to be clear that he was using them in that way as well as in the traditional ways which are basically investor protection arrangements of the type that the Germans, the Swiss, and to some extent the British have been doing now for about 10 years.

I think bilateral efforts probably are an essential complement to any multilateral approach. They can be done more quickly. But I would not lose sight of the need at the end of the day for new multilateral arrangements. That is what I am advocating.

Let me give one or two particulars as to what I have in mind.

If one were to develop a GATT for investment—and it would take a long time to do so, I would be the first to admit—you could start by negotiating a standstill agreement on Government interventions in this process, to hold the fort where you are. That is the way the GATT itself started in 1948 or 1949 in the trade area. You would then move on to try to negotiate rollbacks in the distortions which now exist. The organization itself would police the arrangements with sanctions agreed, hopefully, by the participants as part of the compact.

Now a prerequisite to even get off the ground in this area would be the commencement of international notification and consultation obligations. The state of international investment relations is so embryonic that there is today no inventory of these kinds of practices about which we are talking—a State, in fact, akin to the world's lack of knowledge about trade barriers back in the 1930's, when the trade wars of that time broke out. Nobody knew the extent of trade barriers until the roof fell in. I would hope we could learn from that experience and the parallel experience in the international monetary area to, at a minimum, find out where we stand.

I should say that as I and, I am sure, others on the panel today, raise the problem of investment incentives and performance requirements, we have to tell you in all honesty that we do not know the extent of the practices and what their net economic effect is. We sense that it is very big. We can see in case after case that it is growing.

But we cannot give you an aggregate estimate of what its effects are. We suspect that it is very big, in the billions of dollars. But we do not know that, because there is no complete inventory of these practices nor any comprehensive economic analysis of what their effects are. That would have to be a starting point to get the ball rolling.

The GATT did that 10 years ago in the area of non-tariff barriers. At the end of the Kennedy Round of trade negotiations, it was clear to everybody that nontariff barriers were the main problem in international trade. Alan Wolff knows this better than anybody. But their was no inventory of those practices, no knowledge of their extent and impact.

So, the GATT spent 2 years putting such an inventory together, and that, then, became the base for the Tokyo round or the MTN [Multilateral Trade Negotiations] 7 or 8 years later. A similar first step needs to be taken now in this investment area and I would hope we could promote it.

The final question that I will address, Mr. Chairman, before stopping is this. A critical issue is what would induce other countries to participate in such an international effort.

After all, as I have pointed out, host countries now are able to manipulate pretty much at will the inflows of foreign investment. They negotiate with the firms; they strike a mutually beneficial deal; and in general they are happy with the outcome. Also, the firms themselves do not do badly in this regime, trading off their agreement to performance requirements against getting incentives in tax and in other areas that would induce them to go ahead.

It seems to me that there really are only two elements that are going to induce the kind of change that is needed.

In the short run, the U.S. Government ought to make every effort that it can to use existing international arrangements. There are a number of GATT provisions, there are some OECD exercises which can be used to get at some of these practices. They have not been used vigorously so far. The STR I think now is considering doing so and it should be encouraged in that effort. Every use of existing arrangements should be made.

Moreover, the U.S. Government simply has to give a higher priority to the issue. It never has been given a high-level push, despite 5 or 6 years of work at lower levels. It needs to get a high priority push right now.

Senator Tsongas. Do you see that happening?

Mr. Bergsten. There are some encouraging signs.

In the administration's so-called white paper on trade which was put out last month, I believe, there was a lot of strong verbiage about the need to move in this area, in the GATT and perhaps elsewhere. As a policy statement, I think that was in the right direction.

At the same time, I do not yet see any real push at high levels—at the Ottawa Summit, for example, or in the OECD [Organization for Economic Cooperation and Development] or in the GATT—really to move this issue to the front burner. My own guess is it is going to have to become a central issue of international trade/investment negotiation and this will require a high level push.

Senator TSONGAS. Why is the point person in the administration on this issue?

Mr. BERGSTEN. Well, that is an issue that has been debated over the years, that is, who is the point on international investment issues. It has moved from spot to spot.

Under the trade reorganization plan that was implemented a couple of years ago, lead negotiating responsibility in this area is vested in the USTR [U.S. Trade Representative]. The Treasury Department traditionally has had and continues to have a major role because of the financial aspects, and Treasury, under existing executive orders, chairs the intergovernmental committee that watches over foreign investment coming into the United States.

The State Department obviously has a major role in this through its lead of U.S. delegations to the OECD, and such.

But, if one gets into the serious kind of enterprise that I have in mind, here, one will have to look at exactly the question you raise: Who is in charge, how the Government is organized, is it effectively managing this particular policy area, and so on.

Let me summarize now very quickly.

I said that there are only two developments that I think really will galvanize other countries' interests in this area. One, to put it bluntly, is the threat of retaliation by home countries, notably the United States, as by far the largest home country, against host country manipulation. As I noted already, paradoxically it is only the national interests of the home country that go unrepresented in negotiations between firms and host country governments which now determine the location and nature of a good deal of the world's production.

Such retaliation could take several forms: Actual limits on foreign direct investment by U.S. firms, at least in countries that practice such manipulation; ex ante screening of the terms of such investment, to make sure that they did not adversely affect U.S. interests; or an ex post procedure similar to the section 201 procedures under the Trade Act, which would permit any affected American party to come in after an investment had occurred and complain that his interests had been injured by it, with the usual escape clause procedure then triggered by that event.

Now, I hasten to say that any action by the United States to retaliate or move against manipulations by host countries would be much more effective if carried out jointly with the other main home countries, of which there are only seven or eight. Seven or eight countries are home base to about 85 to 90 percent of foreign direct investment around the world. So you would not even need the whole OECD. You would not need a whole lot of countries to move jointly in this area.

Senator TSONGAS. Is there a sentiment among those nations to do that?

Mr. BERGSTEN. It is mixed.

All of those big home countries also are big host countries. Here I am talking about Japan, Germany, England, France, Switzerland, and Canada as well as the United States. Those are the big seven, along with the Netherlands and, to some extent, Belgium.

Of this group of countries, two or three would be basically on our same wavelength, the one I am talking about here, namely, not

much manipulation in their role as a host country. Here I include Germany, Switzerland, and the Netherlands, basically open economies. This is not to say that they do none of this manipulation. The German states, for example, do some. But basically they are in the same ideological and conceptual framework that we are.

On the other hand, some of those other big home countries—Japan, France, and England—also are frequent manipulators as host countries. Therefore I can tell you from personal experience in negotiating with them, they would be very leery of any moves in this area that even begin to put some international restraint on the national behavior of host countries in the areas about which we are talking today.

So, it is a mixed bag. We clearly would have some allies and some very important ones; but there are others who would have to be brought along. This is why I stress that it would have to be a high level approach.

Retaliation obviously is one possibility.

A second set of measures that I think would make the rest of the world wake up to this problem would be emulation.

Senator DODD. Mr. Bergsten, are you familiar with the so-called D'Amato bill, which is now pending before the Banking Committee?

Mr. BERGSTEN. Yes.

Senator DODD. The bill would place a 9-month moratorium on Canadian investments in this country and would require the same margins in borrowing by Canadian investors.

What do you think of that bill?

Mr. BERGSTEN. Well, my conclusion from all of this, Senator, was going to be that restrictions, retaliation, or emulation——

Senator DODD. How would you characterize the bill?

Mr. BERGSTEN. Well, you could view that in either of two ways. You can view it either as a pause, to think about the question before you decide what to do definitively; but you also could view it at least partially as retaliation. As I understand the motivation behind the bill, it is the action that Canada has taken of the types that I have been talking about in recent months. I think those actions are disruptive and adverse to our interests and, therefore, call for some reaction.

But, by virtue of being a 9-month effort, I think it basically would call a halt in an effort to trigger a serious consideration of the kinds of things about which we now are talking: Should the United States adopt some definitive new policy in this area?

Senator DODD. Mr. Chairman, let me state that I have sent a letter to Senator Percy suggesting that we may want a sequential referral on that legislation. I am not taking a position on the bill because I think we need to know more about it. But it seems to me that it is an issue about which this committee should be concerned. My hope would be that we would get the leadership to agree to a sequential referral.

I will be sending copies of the letter I sent to Senator Percy to everyone on the committee.

I don't want to dwell on that point, however. Again, without reaching a decision on whether or not the D'Amato bill is a good or a bad idea, let's just take the positive side of the argument for example.

Let's say that the Canadian Government is applying what it considers to be a new direction in its domestic energy policy. Is there a pattern of that behavior of trying to squeeze foreign investors as opposed to attempting a real change of direction in domestic energy policy?

In this case I think you will find that Pierre Trudeau and others would make a case that this policy is not designed necessarily to hurt the United States or U.S. energy companies; but rather it is to secure their own energy future. That is the argument they make, that it should not be construed as a retaliation against U.S. energy companies.

Is there a distinction? Do countries try to make that distinction often?

Mr. BERGSTEN. Of, yes. Countries do try to make that distinction.

As I tried to indicate a moment ago, I think it is a valid distinction.

For example, the tax cuts just voted in this body this week, which reduce the corporate tax and provide other investment incentives, are across-the-board measures which would apply to both domestic and foreign firms. They are nondiscriminatory and are clearly a new direction in policy.

Canada and other countries often are motivated by exactly what you say, a new direction in policy, an effort to pursue their national interests as they define them. However, I think one has to look at the effects of those policies in the terms we are talking about today. Is their effect, to put it bluntly, to export their problems to somebody else?

If that is the case, then I think they are objectionable on international grounds.

I would put the new Canadian policy in the context of overall Canadian policy in this area, going back through much of the 1970's. Canada, in 1974, passed a Foreign Investment Review Act, which set up a foreign investment review agency whose mandated job, under Canadian legislation, is to assure that investments coming into Canada "provide significant benefit" to Canada.

This starts the bargaining process.

When a United States, or British, or German firm wants to invest in Canada, all covered investments have to apply to FIRA [Canadian Foreign Investment Review Agency]. What then commences is a bargaining process, through which the Canadian Government, working through its Investment Review Agency, tries to get commitments from the firm to provide some more jobs, to bring in some more technology, to bring in some more capital, to provide some more exports, to substitute for imports, and so on, to achieve significant benefit for Canada.

Now, in some cases that may be perfectly defensible because the firm may have been doing things that either were uneconomic or motivated by its corporate structure rather than what we normally would think of as economic devices. On the other hand, the result may very frequently be, literally, transferred jobs, exports, and technology, from the United States into Canada, or from Britain into Canada.

That is the backdrop against which I consider some of the current Canadian steps a fairly consistent policy, frankly, in attempting to extract additional national advantage which may—I underline "may" as this is not a blanket indictment—which may in many cases have

adverse economic effects on the home countries from which the investments come, largely because of our bulk in that process, the United States.

So, Senator Dodd, I think one has to go beyond intent, to look at the actual impact of the action and if it has "beggar thy neighbor," "export my problem to somebody else" effects, then I think it is a legitimate source for international concern.

This is a typical thing in trade policy. If the Canadian Government decides it wants to transfer production and jobs from Toronto to Nova Scotia through tax measures or some other means, it is perfectly free to do that, obviously. If it wants to shift jobs from Akron to Nova Scotia, that is no good because that would be exporting its problem to us and this ought to be reacted against internationally.

We have done this in the trade area traditionally, and I think we need to do it in the investment area as well.

Senator DODD. I just have a sneaky suspicion that if 80 percent of the energy revenues that were generated in the United States went to a foreign country, we probably would have a hue and cry for some sort of action in the U.S. Congress. But I do not want to use this forum to debate the D'Amato bill.

I appreciate your response.

Mr. BERGSTEN. My very final comment, Mr. Chairman, is to say this. I want to be clear. I am not advocating either the D'Amato bill or that the United States retaliate or emulate the Canadian example. What I am saying is that the pressures created by these developments are going to push us in the direction of retaliation or emulation.

Doug Fraser of the United Auto Workers has proposed both. He has proposed legislation that would require any auto firm producing in the United States to have a very high degree of North American value added in those cars. That would be simultaneous retaliation and emulation. It would be retaliation because it would say to an American firm contemplating investment abroad that you have to have a certain amount of your total value added here at home. That would operate to restrain foreign investment by the auto firms. It also would be emulation because it would say that to sell in our market, you have to have a very high degree of value added here.

That would emulate what Mexico does with its auto decree and what, in fact, many countries do in the auto industry.

So, I see a good deal of pressure developing for retaliation and/or emulation in this area. I think the result of that would be to cut back sharply on the international investment process, which is a beneficial process both to us and to the world. Therefore, I think the day has come where the United States should adopt as a major policy objective trying to do something about this both bilaterally, where that can be done, through using the existing international trade and other rules where that can be done, but, fundamentally, making a major start toward negotiating new international rules of the game—call it a "GATT for investment"—which could deal definitively with this problem for the longer run.

Thank you very much.

[Mr. Bergsten's prepared statement follows:]

Prepared Statement of C. Fred Bergsten

THE CURRENT SETTING

Foreign direct investment has been a major part of world economic activity for many years. The book value of such investment by U.S. firms reached almost $200 billion by the end of 1979, and its market value is much greater. The total assets of the foreign affiliates of U.S.-based firms had reached $500 billion by the end of 1977. Since the United States now accounts for less than one-half of foreign direct investment by all countries, the global holdings of all foreign affiliates must approximate $1 trillion. Annual production by such firms is greater still, probably approaching the $2 trillion level of international trade.

It is thus quite surprising, and somewhat anomalous, that no international rules or institutional arrangements have been developed in the investment area. The trade wars of the 1930s produced the GATT as an essential element of the postwar economic system; it has played a central role in both fostering steady liberalization and containing the protectionist pressures which have continued throughout the postwar period. The competitive exchange-rate changes of the Thirties produced the International Monetary Fund; it too has played a central role in supporting global economic growth and stability. Similar international institutions and legal regimes have developed in virtually every other area of international economic relationships as well, with the notable exception of international investment.

There are three major reasons for this omission. First, investment issues were not very salient when the postwar economic system was created in the late 1940's because of the widespread use of capital controls by most countries outside the United States; aside from some general references in the IMF Articles of Agreement (which permitted restrictions on capital flows), attention was paid to them only in the still-born charter of the proposed International Trade Organization. Second, there has been no intellectual consensus concerning the proper role of international direct investment in the world economy; unlike the virtually unanimous support for free trade (with limited exceptions, under well-defined circumstances) and currency convertibility, the role of foreign investment—and the multinational enterprises which conduct most of it—has been simultaneously hard to analyze definitively, and subject to very different viewpoints both among and within key individual countries.[1]

The third, and perhaps most important reason, has been the attitude of the United States—the driving force behind every major global institutional initiative in the postwar period. U.S. policy toward foreign direct investment has been simple, successful and supportive of U.S. interests: maintenance of open markets to international investment in the United States by firms of other countries, and of open markets abroad for foreign investment by U.S. firms.

There has been very little direct involvement by the U.S. Government in investment issues in recent years, aside from the ongoing programs of the Overseas Private Investment Corporation (OPIC) to insure some U.S. investments in developing countries. With occasional exceptions, and despite occasional domestic criticism of the traditional open attitude toward both outward flows (e.g., as contributing to balance-of-payments deficits in the 1960's and "exporting jobs" in the early 1970's) and inward flows (e.g., because the Japanese were going to "buy up America" in the early 1970's or the Arabs were going to do so more recently), this policy has prevailed throughout the postwar period and promoted both United States and global economic progress. U.S. policy largely dictated global policy in this area, even after the United States lost its dominance on monetary and trade matters, because the U.S. firms continued to account for well over one-half of foreign direct investment long after the U.S. share of world GNP, trade, monetary reserves and most other key international economic variables had dropped to much lower levels.

NEW DEVELOPMENTS

A series of new developments, however, is posing major questions concerning the appropriateness—and political feasibility—of maintaining this laissez-faire attitude, and of the continuing absence of international "rules of the game" and institutional arrangements in the investment area.

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[1] For an effort to explain and rationalize that debate see C. Fred Bergsten, Thomas O. Horst and Theodore H. Moran, *American Multinationals and American Interests* (Washington : The Brookings Institution, 1978) esp. Chapters 1–2.

The basic problem is the increasing degree and sophistication of manipulation of foreign direct investment by most host countries into which such investment flows. Traditional economic theory, and traditional U.S. policy, have assumed that such investment responds primarily to market forces and thus increases global economic welfare—including, usually, the welfare of both the home and host country as well. Indeed, the main source of attack on this view through at least the early 1970's was that the major benefits of the system were accruing either to the multi-nationals themselves or to the home countries where the investing firms were based—either of which were thought to redound to the national advantage of the United States.

Now, however, governments of most host countries have become exceedingly active actors in the international investment picture. Their objective is simple: to maximize the flow of foreign investment into their economies on terms which are supportive of their national economic and social goals. Very few host countries anymore ask the simplistic question of whether or not they want foreign direct investment. Nor, despite recent and anomalous steps to the contrary in Canada and France, is nationalization or ownership usually the question; virtually every host country, including the smallest and poorest, has learned that ownership does not assure control and that control does not require ownership. Indeed, host countries now ask primarily how they can (1) channel foreign investment to promote their own national purposes and (2) attract investments that will do so.

Host countries, both industrialized and developing, use numerous specific methods to achieve these purposes. However, their strategies can be grouped under two broad headings:[2]

1. Incentives

Most host countries offer numerous tax, credit and other incentives to attract investors from abroad. "Subsidy shopping" is a common practice of multinational firms, particularly those which are "footloose" in the sense that they can set up a particular line of production in a wide variety of geographic locations. The result may often be to shift production—which means jobs, technology, exports, etc.—from the home country (often the United States) to the host country, and to do so on a non-economic basis.

Such incentives are also of dubious value to the countries (or U.S. states) which offer them. These entities wind up emulating each other to a large extent, so in essence wind up largely transferring revenues to the firms and the treasuries of the home countries. The representative of one U.S. state development agency, in fact, commented a couple of years ago that "we are all wasting $5 billion annually on this process." So it would be desirable for both home and host countries to find a way out of the incentives business.

2. Performance requirements

To make sure that the investments promote host country objectives, these countries usually insist on a wide array of performance commitments: minimum levels of job creation, minimum export levels (or shares of production), local value-added or content requirements, specified amounts of technology and/or capital transfer, etc.[3] Only firms which commit themselves to such results, through such agencies as Canada's Foreign Investment Review Agency (FIRA) or Mexico's Foreign Investment Commission, are permitted to proceed. The results of course may be adverse to the economic interests of the home country, most frequently the United States: a mandated, very possibly non-economic, shift of production, jobs, technology, exports, etc. to the host country.

The host countries usually combine carrot and stick. If a particular investment is very attractive to the foreign firm, approval alone may be a sufficient inducement for it to comply with the specified performance requirements. If not, the host country government uses its various inventive programs to induce the firm both to come in and to meet the standards. In essence, a bargaining process is created; both sides probe for maximum advantage until a deal acceptable to both is struck. The result, far from earlier views of "sovereignty at bay" or the "global reach" of the multinationals or "imperialist" America deploying "its" multinationals around the world, is an alliance of mutual advantage between

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[2] These problems were first identified in my "Coming Investment Wars?" *Foreign Affairs*, October 1974.

[3] A useful list of such requirements is included in Appendix A of Labor-Industry Coalition for International Trade (LICIT), *Performance Requirements*, March 1981. Many are outlined in *American Multinationals and American Interests*, cited above.

the firms and the governments of host countries—with possible detriment to important economic interests of the home countries (notably the United States). Indeed, the only "empty chair" in such negotiations is that of the home country government; no one, in such negotiations, defends the overall national interests of the home country.

Special attention should be addressed to those performance requirements which are directly related to trade. Host country insistence on 80–100 percent domestic value-added, as is frequently the case in the automobile and other industries, is the functional equivalent of a zero or very low import quota on components and other inputs. Such a quota would be generally outlawed under the international trading rules of the GATT, requiring the country to pay compensation or face legal retaliation from other countries injured by its actions. When a host country achieves the same purpose through its investment policy, however, no international rule applies; indeed, there is not even a requirement for notification of the matter or consultation on it, and it may escape attention altogether until major investments have been made and undoing the damage becomes much more difficult.

Similarly, minimum export quotas violate at least the spirit and intent of both GATT and the new Subsidy Code. Particularly when uneconomic, they in fact must be subsidized in one way or another by the host country; however, the subsidies may be in a portion of the overall investment package completely unrelated to exports and thus exceedingly difficult to trace. In short, some of the basic elements of the international trading rules are being increasingly undermined by these host country investment policies—for which there exist no sanctions or even minimum requirements for notification and consultation.

Some observers would add a third category of host country disruption to the international investment process: deviations form national treatment, as in Canada's "National Energy Policy." Such discrimination certainly does exist, though I am not sure whether it is increasing. In any event, I would prefer to view such moves as simply another type of performance requirement; the firm must accept minority ownership, or other forms of discriminatory treatment, to remain engaged in the country. On the other hand, I would not object to viewing "national treatment" as a separate issue—expecially where it is violated ex post after many years of acceptance, as in the Canadian case, on the grounds that it is extremely important to preserve contractual obligations as a basis for effective international economic arrangements in all areas.

FOREIGN INVESTMENT IN THE UNITED STATES

One more "new development" must be mentioned before proceeding to policy prescription: the increasing role of the United States as a *host* country, as opposed to its traditional role as a home country of multinational firms. The book value of U.S. foreign direct investment still outstrips foreign direct investment here by a factor of almost four: almost $200 billion to a little over $50 billion at the end of 1979. At the margin, however, the inward growth is much greater than the outward growth; the book value of foreign direct investment coming into the United States almost doubled in the five years ending in 1979, whereas outward foreign direct investment by U.S. firms rose by only a bit over 50 percent during the same period. For several years, there has been a greater flow to than from the United States, even in absolute terms, from nations such as Germany and Canada—with economies one-third and one-tenth, respectively, the size of our own.

Most of this investment is attracted by market forces, including broad political considerations. There are few if any inducements offered by Washington, although a number of our state and local governments do offer incentives somewhat similar to those extended by (mainly national) governments in other countries.

The United States is almost alone among host countries, however, in eschewing any effort to control or at least direct the flow of incoming investments. No performance requirements are applied. No registration, let alone negotiation, is required of foreign firms. The United States is clearly the most open market in the world for foreign investors. I believe this policy has been strongly supportive of U.S. interests, but it does differ sharply from trends in the rest of the world at this time.

SOME POLICY POSSIBILITIES

From the standpoint of the United States, but globally as well, there are thus two dominant trends in international direct investment relationships as we enter the 1980's: increasing manipulation by host countries of direct investment from

the United States (and other home countries), and increasing foreign investment in the United States by firms from other nations—often the same nations whose governments are manipulating U.S. investment when the roles of home and host are reversed.

As a result of these developments, a number of proposals have already been made, in the Congress and elsewhere, to reverse the traditional openness of U.S. policy toward incoming investment or at least to insist on reciprocal treatment for U.S. investors abroad—either by liberalization abroad, or by tightening at home. The convergence of these forces suggests the possibility of a new strategy for U.S. international investment policy—a major multilateral effort to develop a new "GATT for investment," to protect the open flow of international investment around the world, with the inevitable possibility of unilateral U.S. steps to protect U.S. interests more directly promoting international interest in negotiating such an arrangement.

The basic objective of U.S. international investment policy should be to limit, and eventually eliminate, manipulations of international investment flows—especially incentives and performance requirements—by all governments. Over the long run, there is only one effective way to accomplish this goal: by negotiating an international "GATT for investment," which would seek to keep governments' hands off international investment flows as the GATT itself has sought—without perfection, but with great measure of success—to keep governments' hands off international trade flows.

Such an institution could, like the GATT itself, start by negotiating a standstill agreement on new government interventions. It would then move on to negotiate to roll back the distortions which now exist. The organization itself, either attached to the existing GATT or created de novo to deal solely with investment issues, would police the agreements—with sanctions agreed by the participants as part of the compact itself.

A prerequisite for even the first step, the standstill, would be the commencement of international notification and consultation obligations. Today's arrangements concerning international investment are so embyronic that there is no complete inventory of national investment policies and practices, a state akin to the world's lack of knowledge of trade barriers when the trade wars of the 1930's broke out in earnest although there is an OECD list, which is currently being updated. The existing GATT membership could thus start the ball rolling by agreeing to compile such an inventory. A similar effort regarding non-tariff barriers in 1969–70 was the first step toward what became the Tokyo Round of Multilateral Trade Negotiations (MTN) almost a decade late; one can envisage a similar scenario, though hopefully on a shorter time scale, regarding international investment. Indeed, it might well take another "MTN," focused on the wide range of problems relating to foreign direct investment, to deal effectively with the problems outlined here.

NEGOTIATING A "GATT FOR INVESTMENT"

The critical question is what would induce other countries to join the United States in a major, time consuming, highly political effort at international institution-building in a field where, as noted already, emotions run high and national interests are both less than clear and sometimes in conflict. After all, host countries are now able to manipulate pretty much at will—limited only by the willingness of the firms to play, and by the amount of budgetary resources available to induce their cooperation; at a minimum, they might insist that any new rules govern at least some of the activities of the firms themselves. The firms generally do alright in the current regime, and are of course skittish about the thought of any new governmental involvement in their activities—even if its avowed objective is subsequently to keep governments out of the investment process. So one should not underestimate the difficulty of negotiating a "GATT for investment."

The international record to date supports such a view. There have basically been three avenues through which the United States, largely due to the effort of the Ford administration in 1975–76 and my own initiatives during the Carter administration, has attempted to address the problems of incentives and performance requirements: [4]

[4] I reported on the efforts of 1977–80 in several speeches while at Treasury; the most relevant are included in *The International Economic Policy of the United States: Selected Papers of C. Fred Bergsten, 1977–79* (Lexington, Mass.: D.C. Heath and Co., 1980) *The World Economy in the 1980s: Selected Papers of C. Fred Bergsten, 1980* (Lexington, Mass.: D.C. Heath and Co., 1981).

In the OECD, an "investment package" was negotiated in 1976 with guidelines covering these areas: the social behavior of the multinational firms themselves; national treatment, and incentives and disincentives. This package represented an important breakthrough, as the first international agreement of its kind. However, there is of course no participation from developing countries—some of which are among the major culprits—and all three components were purely hortatory in nature with no firm commitments or sanctions involved; some OECD members, notably Canada and Australia, resisted even that limited degree of agreement. We made an effort to beef up the national treatment and incentives/disincentives codes in 1979/80, and finally won agreement to review them systematically; that effort is now going on, but is making little headway as far as I know.

In the GATT, the United States has proposed a systematic attack on trade-related performance requirements such as value-added/local content rules and minimum export quotas. My understanding is that other countries have shown little enthusiasm for such an effort, and that discussion even of addressing the concept has been postponed until fall.

In the Development Committee of the IMF/IBRD, a task force (under my chairmanship), composed of both industrialized and developing countries, made some interesting progress in 1979–80 toward agreeing that investment incentives represented bad policy and needed to be curbed. At its meeting in September 1980, the Development Committee remanded the issue to the Executive Board of the World Bank; Bank staff has now proposed a major study, but no action has been taken.

Action to date has thus been quite limited, though the United States has made some efforts over the past five or six years. One clear need is to elevate the priority attached to the issue; it has never been pushed hard at high levels, and it is clear that nothing significant will happen in this area without such a push. The Administration's "White Paper on Trade" included a strong statement in favor of moving expeditiously on trade-related performance requirements, which is certainly a step in the right direction.

At a minimum, every effort should be made to use our existing domestic and international legal framework to attack these practices. For example, the new Subsidy Code may provide some leverage against investment incentives which ultimately amount to export subsidies. Section 301 of the Trade Act may be a basis for attacking some trade-related performance requirements, and would seem to be sanctioned by several sections of the GATT; STR is now investigating a possible 301 case against Canada's performance requirements.

Nevertheless, I am afraid that there are only two developments which will galvanize foreign interest in dealing constructively with these issues. The first development is a meaningful threat of retaliation by home countries, notably the United States as by far the largest home country, against host-country manipulations. As noted before, only the national interests of the home country go unrepresented in negotiations which now determine the location and nature of a good deal of the world's production—negotiations conducted solely by the multinational firms themselves and the governments of the host countries.

Such retaliation could take several forms, actual limits on foreign direct investment by U.S. firms, at least in countries which practice such manipulations; ex ante screening of the terms of such investments to make sure that they did not jeopardize overall U.S. interests; or an ex post procedure, analogous to Section 201 under the Trade Act, whereby any qualified U.S. party could seek to block an investment which it believed to have injured its own economic interest. Any such actions would of course be most effective if carried out jointly by the seven or eight home countries which are the sources of the great bulk of foreign direct investment, though the prospects for achieving such cooperation are clouded by the fact that several of these major home countries (e.g., France, Britain, Japan) are, at least periodically, practitioners of incentives and performance requirements in their sizable roles as host countries as well.

A second set of measures would comprise emulation by major home countries, again notably by the United States, in their growing role as host countries of the manipulation now being carried out by other host countries: imposition of value-added requirements, minimum export quotas, mandatory infusion of external capital and technology, acceptance of minority ownership, etc. The effects of such a U.S. policy would be two-fold: U.S. emulation of Mexico's value-added requirements would hit Mexico directly, by forcing Mexican firms which wanted to sell in the United States to invest in the United States, and indirectly by forcing

Japanese firms which wished to sell in the United States to invest in the United States instead of Mexico.

I hasten to note that both these sets of steps would run counter to the basic tents of tradtional U.S. international economic policy, which have served our national interests well; could easily get out of control once instituted; and could even backfire by giving other countries a justification for doing more of the same. However, I am afraid that such measures are going to happen in the absence of meaningful new international steps to check the proliferation of host-country manipulation:

Douglas Fraser of the United Auto Workers has proposed U.S. local content legislation requiring, by 1985, auto companies with annual sales exceeding 200,000 vehicles to have at least 75 percent North American content and firms with sales exceeding 500,000 vehicles to have 90 percent North American content. This approach would simultaneously emulate and retaliate, hitting both foreign firms which wish to sell in the United States and U.S. firms which invest abroad. The automobile industry is the most likely candidate to initiate such pressure in the United States, because it is probably most subject to host-country manipulation throughout the world. Given the prevalence of such manipulation across industries and the concerns for "equity" in the Congress, however, it is doubtful that any legislation of this type would be limited to a single industry.

Proposals have been made before at least one House Subcommittee to set up a U.S. Foreign Investment Review Agency modeled on Canada'a FIRA; this would be precise emulation and place the U.S. Government at the bargaining table regarding all inward investment which was covered.—bills have been proposed in recent weeks, in reaction to Canada's new restrictions against foreign investors in the Canadian energy sector combined with the spate of new investments sought by Canadian firms in the U.S. minerals sector, to (1) install full reciprocity between United States and Canadian investors in the minerals sector by invoking against Canadian investors the discrimination provision of the Mineral Lands Leasing Act of 1920 and (2) go much further by imposing a nine-month moratorium on all Canadian investment covering more than 5 percent of the equity of U.S. energy firms.

This Subcommittee added amendments to the authorizing legislation for the continuation of OPIC, offered by the Chairman, which would require OPIC to refuse to support any investment subject to incentives or performance requirements which would tend to reduce significantly the positive U.S. trade benefits which would otherwise arise from the investment. This is the first explicit Congressional recognition of the problems caused for the United States by such practices; in its report, the Committee explained that it did so "to counteract the growing practice in developing countries of providing investment subsidies or other incentives, or imposing local content or export requirements or other performance requirements, which tend to distort trade or investment to the disadvantage of the United States economy."

CONCLUSION

These recent steps may be only the beginning. Increasing foreign manipulation of U.S. direct investment creates a growing problem for the U.S. economy. Growing foreign direct investment in the United States provides a new lever—in addition to the traditionally available lever of limiting outward investment by U.S. firms—for doing something about it. It seems only a matter of time before such an inflammatory situation ignites.

For once, we should learn from history. It took a decade of trade wars and vicious exchange-rate competition, which both deepened the Great Depression and contributed greatly to bringing on the Second World War, to convince the world to create international arrangements—the GATT and IMF—which would help prevent recurrences thereof. We should now negotiate a "GATT for investment" to head off the coming investment wars, which will be all the more vicious if world stagflation continues—as unfortunately seems likely—for much of the coming decade. The Subcommittee is to be commended greatly for initiating debate on the topic, which could turn out to be one of the most important in the entire field of international economic policy in the 1980's and beyond.

The CHAIRMAN. Thank you very much, Mr. Bergsten. I think you have just enunciated what one might call the "Bergsten get tough policy."

Mr. Thomas, we are happy to hear from you.

STATEMENT OF ROWLAND H. THOMAS, JR., VICE PRESIDENT, AMERICAS/FAR EAST, DATA GENERAL CORP., ON BEHALF OF THE AMERICAN ELECTRONICS ASSOCIATION, WASHINGTON, D.C.

Mr. THOMAS. Thank you, Mr. Chairman.

My name is Rowland H. Thomas, Jr. I am vice president of Americas/Far East for Data General Corp. based in Westboro, Mass.

Data General is one of the world's leading manufacturers of small computers and related products and services.

Founded just 13 years ago, we now employ almost 15,000 people. About 1 in 3 of these jobs is dependent upon exports. We are growing at a rate of about 30 percent a year, largely because our products increase the productivity of our customers. Worldwide demand is very strong. Our sales this year probably will exceed $700 million.

I am appearing before you this morning on behalf of the American Electronics Association [AEA]. AEA is a trade association of more than 1,500 electronics companies in 43 states. Our members manufacture electronics components and systems or supply products and services in the information processing industries. While our member companies employ more than 1 million Americans and include some of the Nation's largest companies, more than half of our member firms are small businesses, currently employing fewer than 200 people.

We sincerely appreciate the opportunity to present our views on the growing trend of other nations imposing restrictions, performance requirements or otherwise hindering on our ability to invest within their borders, and, hence, our ability to trade in their markets.

Let me start by stating emphatically that from our perspective, investment has become a trade issue. Now that may cut across the grain of tradition in this country, where policy has been that trade and investment should be separate and distinct from one another. But if you are a 13-year-old computer manufacturer and are trying your best to participate fully in world markets, the logic of that distinction easily is lost. For us, the fact of the matter is that we cannot trade in world markets unless we invest abroad.

In order to sell computer systems or other high technology products to customers overseas, there must be a commitment—a commitment made by us—to provide service and maintenance for the products that we sell. We must have the ability to establish local subsidiaries for these purposes. It is for this reason that we view investment and trade as two sides of the same coin. Their interaction is vital since it provides mutual support for each other in world competition.

As has been stated already today, in a growing number of countries, a subtle form of nontariff barrier to trade has evolved that effectively bars U.S. companies like mine from participating in important markets for our products. These are a variety of policies, formal or informal, that may have been adopted by other governments to restrict foreign direct investment. They range from local content requirements to technology transfer considerations. Their aim is to control capital investment and to force the transfer of technology by government fiat.

For young companies such as ours, the most onerous of these are restrictions on our ability to establish local, majority-owned sales and service subsidiaries. In an increasing number of countries, we cannot now establish such subsidiaries unless we are willing to surrender majority ownership to a local partner, and hence, our technology which we developed at great expense. Because technology is our stock in trade, we are not willing to hand it over to a third party.

To do so would severely dampen our future.

We could not remain competitive very long if we chose to base employment, capital investment, and other decisions on political rather than business considerations. Our refusal to do so has locked us out of some promising markets for our products.

You do not normally hear companies complain about investment restrictions or their implications. This is not because the problem is not widespread. It is.

Investment restrictions are among the most formidable barriers that U.S. exporters face today.

Companies do not complain openly because they fear retribution. For years they have had to grapple with investment restrictions on their own, due in large measure to the lack of an aggressive U.S. policy. In some countries, firms have been able to negotiate agreements, often skewed in favor of the host nation, but which are subject to change at any moment. Because they are so tenuous, most firms are reticent to be identified publicly with any criticism of the governments involved.

Let me cite some of the examples of the restrictions that we face.

In Latin America, as you may know, the Andean Pact adopted guidelines for controlling foreign investments about 10 years ago. In its controversial Decision 24 of the Cartagena Agreement, members of the pact agreed to phase out all majority foreign ownership in member countries—Bolivia, Colombia, Ecuador, Peru, and Venezuela—as well as to impose a myriad of other provisions restricting foreign investments.

In line with the Cartagena Agreement, Venezuela, with its very attractive $100 million market for computer products, now is in the process of reducing foreign ownership. Wholly owned foreign subsidiaries organized after January 1, 1974, are required to dispose of 80 percent of their equity by 1988 in order to preserve their classification as commercial sales entities.

Service subsidiaries must divest themselves of 51 percent ownership. Of course, new subsidiaries cannot exceed 20 percent and 49 percent ownership respectively.

Investment regulations are purposely left vague and ambiguous in an effort to maximize the coercive effect on foreign companies.

Probably nowhere is the ambiguity and lack of clear regulation on foreign investments more evident than in Brazil. For my own industry, it is impossible for us to import a minicomputer into Brazil because the market has been reserved for four Brazilian national companies.

In Brazil, products produced by a foreign firm for sale there must have at least 35 percent local content in order for the foreign firm to qualify as a local manufacturer. Although presumably there are few other formal investment restrictions—

The CHAIRMAN. Excuse me, but would you please repeat that percentage.

What local content does a firm have to have?

Mr. THOMAS. It is 35 percent.

Mr. BERGSTEN. It is certainly higher in other industries in Brazil. It must be 35 percent in your industry.

Mr. THOMAS. That's right—in our industry.

Presumably, there are other formal investment restrictions. But the fact is we cannot sell anything in Brazil. Brazil now is considering the creation of a foreign investment institute similar to the Canadian FIRA, to review and, practically speaking, to impose further investment performance requirements on foreign investment.

To make things worse, Brazil is in the process of redefining majority foreign ownership to mean equity participation above 25 percent.

I might add that Brazil now is considering a law to impose the same restrictions on the semiconductor industry by reserving semiconductor markets for national companies.

Our neighbors in Mexico also have imposed investment restrictions. A U.S. company cannot now establish a majority owned sales and service subsidiary in Mexico. Such operations must be 51 percent Mexican-owned, although foreign operations established prior to the adoption of these restrictions have been allowed to remain majority-owned.

In Malaysia, a foreign company has no chance of investment unless it plans only to export and run the equivalent of a processing operation with no intent to sell in Malaysia itself. Only then can a foreign company enjoy majority ownership.

Those foreign concerns that do manufacture there for export must maintain and increase certain employment levels, or else they face a real possibility of losing their majority ownership position.

Finally, in the Philippines, which is a long-standing American trade partner, U.S. companies and other foreign firms only can sell through local distributors. There is a law against direct commercial sales of imported products by a foreign company. Although we are allowed to own wholly manufacturing facilities there, only what is manufactured there can be sold there directly by that company—absolutely no imports.

These are a few examples. There are many more.

By way of contrast, with a few minor exceptions, I understand the United States gives free and open access to foreign investors. Being free traders basically, we believe this is as it should be. However, we also believe that U.S. policy should not only be firm in its support of free flows of investment among nations, it should promote our ability to establish investments in other countries. It currently does not.

Aside from our need to establish local facilities to sell and service products, one might ask if foreign direct investment really is all that important to the U.S. economy. A quick look at the figures provides an emphatic "yes."

In 1979, U.S. overseas direct investment generated a net income to the United States of nearly $25 billion.

A survey by Business International of 124 top U.S. corporations from 1970 through 1977 concluded.

> In almost every conceivable test of what might be considered good or bad for the U.S. economy—outgoing corporate foreign investment must be viewed as good.

Companies in the sample with higher than average foreign investment boosted their U.S. employment by 2.3 percent from 1970 through 1977, while those with less than average foreign stakes decreased their U.S. payrolls by 4.1 percent.

In 1977, the 124 companies exported $24 billion worth of goods, while importing $12 billion.

All of this would suggest the staunch defense of U.S. foreign direct investment abroad. Unfortunately this has not been the case.

The fundamental policy of the U.S. Government toward international investment is neither to promote nor to discourage inward or outward investment flows or activities.

From our perspective, the U.S. policy on outgoing investment bears little relationship to the reality we face in the 1980's. As a nation, we are participants in a global economy. And to remain competitive, our export industries must retain the ability to participate in markets worldwide.

However, I must add that we were pleased to see that the U.S. Trade Representative, the Commerce Department, and others in administration have begun to realize the importance of this problem and have embarked on a road towards achieving solutions, as evidenced by Ambassador Brock's recent trade policy statement.

I am sure that there are any number of ways for the United States to address these issues. I don't want to pretend to have any of the answers. There are people far more expert in international trade and investment policy than I.

However, it appears that a very good place to begin would be to revise this country's policies toward U.S. direct investment abroad and the treatment that American exporters receive around the world. There must be a realization of the vital relationship between investment and trade and the enormous economic benefits that these activities provide.

We do have a policy that reflects this country's commitment to free and open trade and investment flows. What we need now is to be more aggressive in persuading other countries to adopt identical policies.

We in industry fear that if the United States continues on its, current passive and neutral course with respect to investment barriers which other nations have imposed, it will be taken to mean that we accept their actions. We must address these trade limiting restrictions on investment.

Thank you very much.

[Mr. Thomas' prepared statement follows:]

Prepared Statement of Rowland H. Thomas, Jr., on Behalf of the American Electronics Association

Mr. Chairman and members of this distinguished committee.

My name is Rowland H. Thomas, Jr. I am Vice President, Americas/Far East for Data General Corporation based in Westboro, Massachusetts. Data General is one of the world's leading manufacturers of small computers and related products and services. Founded just thirteen years ago, we now employ almost 15,000 people. About one in three of these jobs is dependent on exports. We are growing at a rate of 30 percent annually, largely because our products increase the productivity of our customers. Worldwide demand is great. Our sales will likely top $700 million this year.

I am appearing before you this morning on behalf of the American Electronics Association. AEA is a trade association of more than 1,500 electronics companies in 43 states. Our members manufacture electronics components and systems or supply products and services in the information processing industries. While our member companies employ more than one million Americans and include some of the nation's largest companies, more than half of our member firms are small businesses employing fewer than 200 people.

We sincerely appreciate the opportunity to present our views on the growing trend of other nations imposing restrictions, performance requirements or otherwise hindering on our ability to invest within their borders, and hence our ability to trade in their markets.

Mr. Chairman, let me start by stating emphatically that from our perspective, investment has become a trade issue. Now that may cut across the grain of tradition in this country where policy has been that trade and investment should be separate and distinct from one another. But if you are a thirteen year old computer manufacturer and trying your best to participate fully in world markets, the logic of that distinction is easily lost. For us, the fact of the matter is that we can't trade in world markets unless we invest abroad.

In order to sell computer systems or other high technology products to customers overseas there must be a commitment—made by us—to provide service and maintenance for the products we sell. We must have the ability to establish local subsidiaries for these purposes. It is for this reason that we view investment and trade as two sides to the same coin. Their interaction is vital since it provides mutual support for each other in world competition. Much as the clipper ships were the primary vehicle of trade on the 19th century and before, the ability to invest in manufacturing, sales and service operations is a primary vehicle of trade today.

In a growing number of countries, however, a subtle form of non-tariff barrier to trade has evolved that effectively bars U.S. companies like mine from participating in important markets for our products. These are a variety of policies, formal or informal, that have been adopted by other governments to restrict foreign direct investment. They range from local content requirements to technology transfer considerations. Their aim is to control capital investment and to force the transfer of technology by government fiat. In some cases, they take the form of distinct governmental policy. In many other cases, however, they are unwritten, much less distinct and subject to the whims of political expediency.

For young companies such as ours, the most onerous of these are restrictions on our ability to establish local, majority owned sales and service subsidiaries. In an increasing number of countries, we cannot now establish such subsidiaries unless we are willing to surrender majority ownership to a local partner, and hence, our technology which we developed at great expense. Because technology is our stock in trade, we are not willing to hand it over to a third party. To do so would severely dampen our future.

The ability of an American company to take advantage of business opportunities in a rational and timely way is limited if it has to go back on every occasion to the "majority" owner and obtain approval for such actions. The majority owner may have no interest in or knowledge of the business and may be unable to appreciate the dynamics of situation as they arise.

Unlike traditional American and European corporate forms, the shareholders in corporations elsewhere (especially Latin America) exercise more power in the operation of those companies by virtue of local law. And local laws are usually heavily weighted to protect local interests in the event of conflict. The availability of voting trusts and other fiduciary devices and the ability to bring derivative and non-derivative stockholder actions in local courts is generally lacking in most developing nations. Even with the optimum drafting of agreements, the American minority shareholder is still left in a rather tenuous position.

In addition, the fact that the U.S. interest will never achieve majority control might be a disincentive to increasing investment in the country—investment that would normally:

1. Provide additional capital to expand capacity;
2. Create additional employment locally;
3. Encourage competition;
4. Stimulate purchases of local supplies and equipment; and
5. Provide technical training and local human resources development.

Having control over one's operations, being able to react promptly to opportunities and not having to clear routine administrative matters with a majority

partner who may be unfamiliar with the overall business objective and market conditions are all reasons why companies can accept ownership restrictions only at great cost.

We could not remain competitive very long if we chose to base employment, capital investment and other decisions on political rather than business considerations. Our refusal to do so has locked us out of some promising markets for our products.

You do not normally hear companies complain about investment restrictions or their implications. That's not because the problem is not widespread. It is. Investment restrictions are among the most formidable barriers that U.S. exporters face today.

Companies do not complain openly because they fear retribution. For years they have had to grapple with investment restrictions on their own, due in large measure to the lack of an aggressive U.S. policy. In some countries, firms have been able to negotiate agreements, often skewed in favor of the host nation, but which at least give them some limited access. These arrangements are something less than secure and subject to change at any moment. Because they are so tenuous, most firms are reticent to be identified publicly with any criticism of the governments involved.

Let me cite some examples of the kinds of restrictions we face.

In Latin America, as you may know, the Andean Pact adopted guidelines for controlling foreign investments about ten years ago. In its controversial Decision 24 of the Cartagena Agreement, members of the Pact agreed to phase-out all majority foreign ownership in member countries—Bolivia, Columbia, Ecuador, Peru and Venezuela—as well as to impose a myriad of other provisions restricting foreign investments.

In line with the Cartagena Agreement, Venezuela, with its very attractive $100 million market for computer products, is now in the process of reducing foreign ownership. Wholly owned foreign subsidiaries organized after January 1, 1974, are required to dispose of 80 percent of their equity by 1988 in order to preserve their classification as commercial sales entities. Service subsidiaries must divest themselves of 51 percent ownership. Of course new subsidiaries cannot exceed 20 percent and 49 percent ownership, respectively. Investment regulations are purposely left vague and ambiguous in an effort to maximize the coercive effect on foreign companies. For example, in Venezuela, it is left unclear whether or not a foreign investor would be allowed to enjoy majority ownership of a Venezuelan subsidiary if he agreed to build a manufacturing plant there.

Probably nowhere is the ambiguity and lack of clear regulation on foreign investments more evident than in Brazil. U.S. firms wishing to do business in Brazil have had to cope with a variety of trade barriers through the years, ranging from local content requirements for products sold there to import deposit fees that virtually choke off most trade. The import deposit fees in Brazil are now being eliminated, but in their place has come a wide variety of taxes to inhibit imports. For my own industry, it is virtually impossible to import a minicomputer into Brazil because the market has been reserved for four Brazilian national companies.

Products produced by a foreign firm in Brazil must have at least 35 percent local content in order for that foreign firm to qualify as a local manufacturer. Although presumably there are few other formal restrictions on foreign investment, the fact is we cannot sell anything in Brazil.

Brazil is considering the creation of a Foreign Investment Institute, similar to the Canadian FIRA, to review and, practically speaking, impose further performance requirements on foreign investment. To make things worse, Brazil is in the process of re-defining majority foreign ownership to mean equity participation above 25 percent. I might add that Brazil is now considering a law to impose the same restrictions on the semiconductor industry by reserving semiconductor markets for national companies.

Our neighbors in Mexico have also imposed investment restrictions. A U.S. company cannot now establish a majority-owned sales and service subsidiary in Mexico. Such operations must be 51 percent Mexican-owned, although foreign operations established prior to the adoption of these restrictions have been allowed to remain majority-owned.

An interesting twist in Mexico is its use of investment restrictions to re-locate or cause shift in their population away from urban areas such as Mexico City. In its Maquila program, the government has defined certain zones, which are now

being expanded, where foreign firms are allowed to establish wholly-owned manufacturing facilities. Foreign entities electing to manufacture in these zones, located in outlaying regions along energy supply lines, can only sell 20 percent of what they produce in Mexico. The remaining 80 percent must be exported. Majority owned Mexican enterprises operating outside of these zones have complete freedom to sell in the Mexican market.

These problems are not confined to Latin America. In Malyasia, a foreign company has no chance of investing unless it plans only to export and run the equivalent of a processing operation with no intent to sell in Malaysia itself. Only then can a foreign company enjoy majority ownership. Those foreign concerns that do manufacture there for export must also maintain and increase certain employment levels or else they face a real possibility of losing of their majority ownership position.

Finally, in the Philippines, a long-standing American trade partner, U.S. companies and other foreign firms can only sell through local distributors. There is a law against direct commercial sales of imported products by a foreign company. Although we are allowed to own wholly manufacturing facilities there, only what is manufactured there can be sold there directly by that company—absolutely no imports.

Again, however, the rules can bend when it suits the particular country's needs. For instance, one American firm with substantial investment in a manufacturing plant in the Philippines, was given permission to import and sell products equal in value to what it exported from that plant. Later without warning the company was told it could not import and sell products that are presently made in the Philippines.

These are just a few examples. There are many more. More than restrictions on investment, they are really non-tariff barriers to trade. All we want is a fair chance to sell our products.

By way of contrast, with a few very minor exceptions the United States gives free and open access to foreign investors. Being free traders basically, we believe that is as it should be. We also believe that U.S. policy should not only be firm in its support of free flows of investment among nations, it should promote interests in establishing investments in other countries. It currently does not.

Countries imposing investment restrictions base their policies on rationales which do not justify the distortions they cause. While internal political considerations may seem to make such policies both a desirable and convenient means of controlling the activity of foreign investors, the long range consequences are likely to be as damaging to the host country as they are for other countries and the international trading community at large. We have witnessed this in South Korea. After years of imposing investment restrictions, that government last year eliminated these restrictions in hopes that it will help rejuvenate their economy. I expect that the economic problems currently experienced in Brazil are in part attributable to their restrictive investment and trade policies.

In Brazil's computer sector, four firms set up by the government have a monopoly on the market which is the sixth largest in the world. This effort to create a domestic minicomputer industry is failing because oligopoly power is too concentrated and because they have no outside competition. And competition is what normally would drive companies to new technological achievement. In Brazil, the national companies are producing obsolete products that do not meet that nation's needs and for which there is already a glut on world markets.

Aside from our need to establish local facilities to sell and service products, one might ask if foreign direct investment is really all that important to the U.S. economy. A quick look at the figure provides an emphatic "yes"! In 1979, U.S. overseas direct investment generated a net income to the United States of $24.7 billion.

Business Week magazine recently noted that the really successful U.S. multinationals like Caterpillar, IBM and Texas Instruments are not the companies that are suffering from this country's current industrial malaise. The erosion of the U.S. industrial base is most serious among companies that have been primarily national—steel, rubber, automobiles. As the Conference Board puts it: "The business equivalent of fortress America hasn't worked. Companies losing market share and jobs at home are precisely those that have invested least abroad. Those holding their own and even adding to U.S. employment and exports are companies that taken advantage of global investing."

A survey by Business International of 124 top U.S. corporations from 1970–1977 concluded "in almost every conceivable test of what might be considered good or bad for the U.S. economy—outgoing corporate foreign investment must be viewed as good." Companies in the sample with higher than average foreign investment boosted their U.S. employment by 2.3 percent from 1970–1977, while those with less than average foreign stakes decreased their U.S. payrolls by 4.1 percent. In 1977, the 124 companies exported $24 billion worth of goods from the United States while importing $12 billion, racking up a huge surplus for the United States.

All this would suggest a staunch defense of U.S. direct investment abroad. Unfortunately, this had not been the case.

The United States has traditionally maintained a position of neutrality with regard to U.S. direct investments abroad. This policy has been described as one ranging from "studied distance" from business interests to opposition when translated into specific actions and programs.

The fundamental policy of the U.S. Government toward international investment is neither to promote nor discourage inward or outward investment flows or activities. The Government, therefore, normally avoids measures which would give special incentives or disincentives to investment flows or activities and does not normally intervene in the activities of individual countries regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest.

Concern over this policy of neutrality and the failure of the United States to address investment performance requirements is growing. The effects of investment restrictions are being felt and there has been puzzlement over the U.S. position.

From our perspective, the U.S. Government's lack of aggressiveness with regard to investment restrictions imposed by others, increases the burden on American exporters. As a nation, we are participants in a global economy. And to remain competitive, our export industries must retain the ability to participate in markets worldwide.

However, I must add that we were pleased to see that the U.S.T.R., the Commerce Department and others in the administration have begun to realize the importance of this problem and have embarked on a road towards achieving solutions as evidenced by Ambassador Brock's recent trade policy statement.

The history of the U.S. auto industry may help illustrate how important full participation really is. The competitive difficulties Detroit has been faced with did not just suddenly appear on the horizon. They began more than two decades ago when U.S. auto makers were effectively stopped from selling automobiles in several major international markets. In Japan in the late 1950's and early 1960's, it was impossible to import more than a handful of American cars, due to a pretty successful combination of import quotas and high tariffs.

I would suggest to you that had Detroit participated fully in the world marketplace for automobiles at that time and since, America would have produced a fuel-efficient car long ago. But for any number of reasons, U.S. automakers did not fully participate. And at least in part, that is the reason for the catch up game we are playing today.

I am sure that there are any number of ways for the United States to address these issues, but I won't pretend to you to have all the answers. There are people far more expert in international trade and investment policy than I. However, it appears that a very good place to begin would be to revisit this country's policy toward U.S. direct investment abroad and the treatment that American exporters receive around the world. There must be a realization of the vital relationship between investment and trade and the enormous economic benefits that these activities provide. We do have a policy that reflects this country's commitment to free and open trade and investment flows. What we need is to be more aggressive in persuading other countries to adopt identical policies.

We in industry fear that if the United States continues on its current passive and neutral course with respect to investment barriers other countries have imposed, it will be taken to mean that we accept their actions. We must address these trade limiting restrictions on investment.

Thank you. I would be happy to answer any questions you might have.

The CHAIRMAN. Thank you, Mr. Thomas.
Mr. Wolff.

STATEMENT OF ALAN WILLIAM WOLFF, ON BEHALF OF THE LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE, WASHINGTON, D.C., ACCOMPANIED BY BRIAN TURNER, INDUSTRIAL UNION DEPARTMENT, AFL–CIO, WASHINGTON, D.C.; AND ALLAN CORS, CORNING GLASS WORKS, CORNING, N.Y.

Mr. Wolff. Thank you, Mr. Chairman.

My name is Alan Wolff. I am counsel to the Labor-Industry Coalition for International Trade [LICIT].

With me this morning are Allan Cors of Corning Glass Works, who is industry coordinator for LICIT, and Brian Turner, of the industrial union department of the AFL–CIO, who is labor coordinator for LICIT. They also will be available for any questions you might have.

The Chairman. I think one of the encouraging things is their joint appearance here. If both management and labor are agreed that there is a problem in which they have a common interest and if they are possibly agreed on some of the solutions that ought to be taken, then we are a long way down the road to some remedies.

Mr. Wolff. Well, there are few enough of us who recognize this type of problem. I think most of us are gathered in this room on both sides of the table.

The Chairman. Well, we hope as a result of the clear voices that are being heard this morning there will be more, if not converts, at least more knowledgeable people on this subject.

Mr. Wolff. LICIT is a coalition of corporations and labor unions who seek to promote the common interests of American workers and business in promoting increased trade and a balanced, equitable international trade policy for the United States.

We welcome very much the opportunity to testify. The use of export performance requirements is increasing and the issue should be of greater and growing concern to the United States.

We very much appreciate your role, Mr. Chairman, in bringing the attention of the Congress to these trade-related performance requirements.

As noted, the recently released statement on U.S. trade policy by Ambassador Brock specifically mentions trade-related performance requirements as an issue to be addressed by U.S. trade policy.

I might say that in the last round of trade negotiations, we did not see this as an issue. It was not brought to our attention. Part of the reason is that U.S. firms, who are subject to trade-related performance requirements, do not complain, by and large. They have made their deal. It is the price of access to a market or the price of access to an incentive program. They are not in a position to complain about them.

We negotiated new trade rules. We have now cut tariffs now down to an average of around 4 percent in industrial countries. We have eliminated the use of quotas in industrial trade among industrialized countries.

These benefits are beginning to be severely undercut by governments dealing directly with investors. It is an extraordinarily serious problem.

Marina Whitman, an economist and vice president of General Motors, released an essay this month which points out very lucidly

how investment performance requirements affect the auto industry. They are most visible, I think, in that industry, although increasingly they are being witnessed in the new growth industries like semiconductors and computers.

Senator TSONGAS. Let me interrupt you, if I might.

Most of the high technology firms are nonunion. I would guess that the kind of company affected, with the UAW being an obviously exception, tends to be less unionized than the kind of company that would not be engaged in international trade. Would that be the case?

Mr. WOLFF. It is true of at least semiconductors, and I suspect it is true of the computer area as well.

Senator TSONGAS. Probably the reason that there has not been this outcry from organized labor is simply because, absent the UAW, they have not been affected by it.

Mr. WOLFF. I think that's true. We only are beginning to feel the effects. The Mexican auto decree went into effect in 1977. A number of analysts say that it will increase Mexican automobile component exports by about $5 billion. Now that is a lot of trade. When those exports show up in the United States and elsewhere, people will begin to take note.

Mr. TURNER. I would like to comment on that somewhat, Senator Tsongas.

One of the most curious aspects of this whole performance requirements area—and maybe my colleague, my counterpart, Allan Cors can comment on this further—is that it has remained hidden in the closet, so to speak, precisely because the firms are not in a position to complain. Yet I think they have plenty about which to complain.

Unions, by the nature of their activities, are not engaged directly in overseas commercial activities. We only tend to know about developments in international trade and investment when they are brought to our attention from other sources.

Going to the number of industries that are affected, if you look just at the automotive sector, where the performance requirements are most widespread today, there are twice as many workers in the parts and supplies industries in unions outside the UAW as there are within that great union. It has been, I can testify, a relatively recent discovery on the part of all of those unions as well that, in fact, we were facing a problem here.

So I think there is more than just the patterns of which sectors of the economy are organized that are at stake.

Senator TSONGAS. Let me say that I have been advocating what I call, for lack of a better term, a "new unionism," which argues that unions should be participants and should be concerned about the health of the company and not only the benefits they can get from it. This would include decisionmaking, information sharing, and that kind of thing.

You may find that interesting.

Mr. CORS. Senator, if I might add a comment to what Brian has said, I think one of the biggest problems we have in getting this out on the table is that so many companies are reluctant to talk about these problems. Many of these situations occur under conditions that are very out front, such as the situation in Mexico, where the requirements are known now. Many others occur in situations where the com-

pany making an investment is not made aware of the conditions that are going to be imposed upon them until they actually have begun the investment in the country. I know of many occasions where this has occurred.

Our biggest problem is getting companies to come forward and to make this known to us, to the Government, and to this committee.

Senator TSONGAS. I must say that in the 7 years I have been sitting on committees involved with international investment and international trade, this always has been a back-burner issue. I suppose t is just a function of the animal, and this is just another example.

Mr. WOLFF. Senator, earlier you asked the question, isn't it an economically rational decision when a company accepts an incentive and goes into a country. It is for the company, but not necessarily for the United States.

I think previously companies made decisions on the basis of low-factor costs, such as low wages and access to raw materials at a better price.

Senator TSONGAS. You don't believe, then, that what is good for General Motors is good for America.

Mr. WOLFF. No, I would say I don't.

Senator DODD. What was the answer?

Mr. WOLFF. No. [General laughter.]

To get back to General Motors, Marina Whitman's piece is particularly interesting because she is writing not only on the basis of her background in international economics but her experience for the last 18 months at General Motors. She lucidly points out that patterns of trade and investment in the automotive iudustry are fostered not just by competitive pressures but more and more by complex requirements imposed by sovereign governments. She says that:

> What occurs beneath the surface in the day-to-day political and administrative policies and practices of national governments may have greater impact on current operations. In our effort to group countries in terms of degree of risk, it is significant that we have adopted a weighted scale in which 60 percent of a country's score reflects developments in the area of microeconomic policy and regulation.

So she is saying that the change of government in Iran or a coup in another country is less of a factor of risk than these kinds of deals about which we are talking, where a government negotiates the conditions under which a company can operate.

This is quite a change in thinking in corporate board rooms.

The implication, clearly, from her essay is that existing institutions are not adequate and that the GATT is not adequate. I would agree with Fred Bergsten in that regard, although I don't think the provisions of the GATT have been tested adequately. No one has brought a case in recent years against local content requirements or export performance requirements. If someone did, I think you would have a very good chance of winning the case.

It is not just automotive equipment that is being affected. It is electrical machinery and manufactured goods of all kinds. It is causing a reassessment of policy by a number of people in this country, the UAW most notably, with Doug Fraser's proposals in the last couple of weeks. Also the Motor Vehicle Manufacturer's Association has

become more active in assessing the effects of these policies on its members in recent months.

I think this reassessment is very important. LICIT welcomes this development.

The kinds of performance requirements that I think deserve the greatest amount of attention right now are export performance requirements. Our firm dealt with a client that was thinking of going into Egypt. Part of the deal was to have an export performance requirement equal to 50 percent of its production—not necessarily 50 percent of what the firm made, but something equivalent to 50 percent the value of its production which it would export from Egypt.

Where would that product go? They had no idea. What would they be exporting? They really had no idea. But the world market was about to get a certain quantity of Egyptian goods which otherwise would have never been exported. Maybe it would turn out to be economically rational and maybe it would not.

Volkswagen of Brazil, about 1 year ago, was required by the Brazilian Government to increase its exports of cars by $10 billion over a 10-year period. Those cars largely go to Nigeria. Now who lost in that transaction? Perhaps German production will be curtailed; perhaps the Nigerian automobile industry won't grow as fast; perhaps, with the advent of the world car, U.S. exports are inhibited.

Increasingly, world trade is being created and stimulated by entirely artificial means.

Other forms of export performance requirements include requirements to export a certain amount of annual output, say 30 percent, or requirements to balance foreign exchange accounts, meaning that whatever you import must be balanced by an equivalent amount of exports.

Senator TSONGAS. Are you aware of any instances where the American Ambassador to a country—let's take Brazil—has met with his counterpart in the Brazilian Foreign Ministry and raised this issue?

Mr. WOLFF. Not specifically in Brazil. But, yes, certainly in European countries. France has a number of performance requirements. In Mexico, in bilateral discussions between the two Governments, the Mexican auto decree has been the subject of consultations.

I think Mexico and Canada are the two most egregious examples of the use of performance requirements. They affect us the most. Brazil probably is just as bad. It's just that these two countries are on our borders and have received more attention.

The CHAIRMAN. Since you are being specific, let me say that President Sadat will be here next week. Presumably the discussions will be a kind of sweep of all American-Egyptian concerns. Will the draft investment treaty that we have under consideration with Egypt resolve all the problems in that bilateral relationship?

Mr. WOLFF. It will be a step forward, but I don't think it will address these problems adequately. It is one of the problems for negotiation.

Fred Bergsten has mentioned a GATT for investment. That is an awfully ambitious project, with not a great deal of international support. In the bilateral investment treaties, the country on the other side has an awful lot of interest which they see in quite a different light than we do. We tried negotiating an agreement with Singa-

pore and have explored the possibility with a couple of other developing countries, Egypt included. Increasingly these countries seek a recognition of their freedom of operation with respect to imposing requirements on investors.

It is not going to be a cure-all.

Senator TSONGAS. But nobody negotiates with you if they perceive that you don't take the issue seriously.

Mr. WOLFF. Exactly. I think that is the major problem. It has not been a high priority for the United States. I suspect the reason is that there has not been enough political pressure applied with respect to these issues.

In the trade negotiations, we negotiated what U.S. industry and labor came to us and asked us to negotiate. Performance requirements were on no one's list. Part of that is the problem of organization of the U.S. Government. Investment was handled quite differently and and distinctly and by other people who were not involved in trade negotiations. But, even if it had been handled by one set of negotiators, the interest was not there.

As you bind countries' hands with respect to what they can do with regard to trade restrictions, increasingly they have to turn and will turn to investment requirements. They are doing so, and it is very effective. I think it is far more effective than a tariff.

Senator DODD. Has there been an historical provocation? I am trying to figure out why this occurs to the extent that it does, particularly in the less developed countries. I am not sure today what performance requirements we attach to foreign assistance. I know that some years ago we had some rather significant performance requirements with regard to U.S. assistance.

What is your opinion on that? Have we provoked some of these performance requirements as a result of our own requirements in foriegn assistance?

Mr. WOLFF. I don't think so. I think there has been a feeling on the part of the developing countries that they are not equipped to deal with multinational corporations; that these corporations are very powerful; that the benefits from these corporations to the local economy are limited; and that the only way to even up the score is to write into the contract when the investor comes in exactly how it will perform.

To some extent, some of these things may be justifiable in terms of development needs. But we are getting far beyond that. We are getting to a beggar thy neighbor policy.

As I said, the United States is only one of the losers. There are no countries that are more protectionist than the developing countries vis-a-vis each other. It is difficult to try to move goods, such as shoes or textiles, into Brazil or Korea.

Similarly, I think performance requirements are adversely affecting other developing countries just as much as us.

Senator TSONGAS. But the reason they do it is it works. It works, as long as everyone else stands back and does not do anything. It benefits the particular nation state. Unless you stand back and say no more, we all will do the same thing.

Mr. WOLFF. That's right. We have not taken a stance on this issue. We are just beginning to recognize it with respect to Brazil, Mexico, and Canada.

Fred Bergsten stimulated the only concern and consideration within the U.S. Government that existed while he was there. The result has been some greater attention in the international institutions. But it is still the United States humoring the United States. We want a study—well, we will give you a study; it will be very slow; it will take years to get any results. There are really no negotiations actively in prospect now.

Senator DODD. I may be getting ahead of our presentation of your statement. I was reading about the bench mark survey that was done in 1976, under the International Investment Survey Act. Do we know it works? Have there been any studies done to compare countries? Argentina seems to be the only country mentioned in Latin America and that country has had some unique political problems, so it may not be a good example. Are there other less developed countries that have not engaged in the kind of performance requirements that so many others have? Has there been any survey or study to compare what the economic benefits are to a nation that does not engage, at least to the extent that the majority of them do, in any comparison of their own economic growth and potential growth?

Mr. BERGSTEN. I might comment on that because one of the things that I did while I was in the Government was chair a task force on this issue set up by the Development Committee of the International Monetary Fund and World Bank. We had a committee—I think the only one of its type that so far has existed—comprised of representatives from both industrialized and developing countries to talk about exactly this problem. The overwhelming consensus on the point you raised is that practically everybody does it. In fact, we never quite asked the question, as you quite rightly did, is there anybody who does not do it. We should have asked that question. But certainly implicit in our work was the judgment that there was nobody who really was not participating in this game among the developing countries.

The nature of the requirements differed. The nature of the incentives differed. But almost everybody was doing it. This reinforces the point Alan was making. Since they all do it, it may have the effect of shifting investment to them as a group. But they really then are emulating each other and robbing each other's treasuries in some sense.

It was really very interesting. The task force that I chaired had Mexicans, Brazilians and people from India or the Philippines on it. It did come to a couple of joint conclusions which give at least some modest hope that you could move in this area. I will read from the conclusions:

> The task force felt that such competition among host nations in granting investment incentives may be counterproductive, especially when incentive packages are custom tailored to lure a specific project to a nation or region. The task force endorsed the objective of seeking an understanding which would limit the adverse effects of foreign investment incentives.

Now this was only a task force. It was several stages removed from an international agreement, to put it mildly. But it gave me at least some modest encouragement that, if the United States did take a forceful initiative to move in this area, one might be able to get some responsiveness.

Mr. WOLFF. I think Hong Kong and Singapore probably are on the lighter end of the scale in terms of placing these requirements on

people. But I think one would have to qualify that. We don't know enough about it. I think probably Singapore is very interested when it hands out incentives to look at the degree of technology transfer. So I suspect even in Singapore there would be some significant problems.

Our data is very poor and I don't know quite how you would improve it. You really have to talk with individual firms and get them to talk quite freely. You would find that a number of the countries in Europe, France, the United Kingdom and others, are major practitioners of performance requirements of one sort or another as well.

I understand that the British have been dragging their feet on allowing the study that Fred was instrumental in getting started and at this stage are preventing it from going forward, perhaps because they feel that the scrutiny would turn toward them as well.

Senator TSONGAS. You obviously believe that the United States is the net loser in this process and that somebody else is the net gainer. Obviously these people believe that these practices are in their national interest.

Mr. WOLFF. Maybe.

But look at the development of the computer and semiconductor industries in Europe. The European market is the fastest growing market for those goods at this time. However, the European share of that market is declining. They have done an awful lot to intervene directly, thinking that it would increase their ability to have a share of the world market. But that intervention is a failure.

One could argue, I think persuasively, that it would have been far better not to engage in these performance requirements and trade restrictions and to allow investment to take place freely, and that it would have done so naturally.

I do not know that you can successfully extract the leading edge of technology from the United States or any other source by government fiat.

Mr. BERGSTEN. May I just elaborate very briefly on one point Alan made in his very correct statement that we need to know much more about this?

He suggested that one way to find out was from the firms. The other way to find out is to levy requirements on governments themselves to file notification of what they do and file complaints about what other countries do.

This is what was done in the GATT in compiling the inventory on nontariff barriers a decade ago, which became the basis for the whole Tokyo Round.

Now at that time—and Alan remembers this well—a lot of countries were not enthusiastic about listing their nontariff barriers. There had to be a lot of high-level political push to get even that much done. Now it seems like a rudimentary thing. Now we have codes and rules of the game and such things.

We are in the exact same place now on the investment issues that we were on the nontariff distortions 10 or 12 years ago. I think the same process, with a strong push, could be initiated.

The CHAIRMAN. Let me ask Mr. Wolff if he has completed what he primarily wants to say in his statement before our conversation gets too general.

Mr. Wolff. Let me mention a couple of suggestions.

On the data collection side, we have too little. There are several studies underway. Much more analysis can be done. The benchmark survey of the U.S. direct investment abroad could really benefit greatly from additional analysis and additional information.

Let me turn to some recommendations, if I might, in closing.

One of these is to improve the data and to have the GATT or OECD or similar organization to inventory performance requirements and related issues. That would be very useful. I think countries would, as they were required to report such things, find that they themselves had a significant interest in what others were doing to them and to their interests.

Let me suggest that it is not sufficient just to raise these matters for study in the GATT and in the OECD, although by itself that would be very useful.

First, I think the improved dispute settlement process in the GATT that was negotiated in the Tokyo Round ought to be tried. Cases ought to be brought by the United States and others against these performance requirements. Cases could be brought against countries under the Subsidies Code that was negotiated in the Tokyo Round of Multilateral Trade Negotiations. Additional steps could be taken through the International Monetary Fund [IMF] and the World Bank Group. The IMF and the World Bank regularly review the macroeconomic policies of countries that benefit from the credits available from those institutions. It seems to me that trade-related performance requirements ought to be a key issue in the review of a country's policies, and recommendations could be made by those institutions in the best interests of the countries involved.

The International Finance Corporation of the World Bank Group could review the use of performance requirements which involve their projects. U.S. executive directors, over whom we do have control, can take into account the adverse effects on international trade and investment in voting on projects which involve trade-related performance requirements. All of those would come within the jurisdiction of this committee, I believe.

I mentioned already that we have to improve our data base. I think we have moved beyond the point where we can just talk about these issues. Concrete steps must be taken.

In closing, I would state our appreciation, again, Mr. Chairman, for your holding these hearings which I think mark a very important beginning of a comprehensive look at this problem.

[Mr. Wolff's prepared statement follows:]

Prepared Statement of Alan William Wolff on Behalf of the Labor-Industry Coalition for International Trade

Mr. Chairman: My name is Alan Wolff, and I am counsel to LICIT, the Labor Industry Coalition for International Trade. LICIT is a coalition of corporations and labor unions that seeks to represent the common interests of American workers and American business in promoting increased, balanced, and equitable international trade. Without reference to outdated slogans of "free trade" and "protectionism," LICIT supports adoption of government policies and industry practices that encourage open, fair competition for foreign products in the United States market, as well as for American-made products in foreign markets.

LICIT welcomes the opportunity to testify at these hearings on United States policy toward international investment. The issue I will address is the increasing use of export performance requirements imposed on international investors by host governments. This trade and investment policy issue is of great concern to the members of LICIT. We appreciate that it is also of concern to you, Mr. Chairman. You have taken the initiative in bringing attention in the Congress to the problems of these trade-related performance requirements and have considered legislative approaches that might be proper to deal with them.

LICIT, in trying to draw attention to the significance and seriousness of trade-related performance requirements, published a paper on the subject in March of this year. We have also discussed the issue and raised our concerns with members of the Administration and the Congress. LICIT is pleased to have expanded public debate and attention on this subject. The issue is now receiving serious attention by the Administration, the Congress, and among professional economists and business and labor organizations concerned with international economic policy.

The recently released statement on U.S. Trade Policy specifically mentions trade-related performance requirements as an issue to be addressed by U.S. Trade Policy. The statement says the United States "will deal with these issues and over the longer term seek to negotiate new multilateral disciplines." In the Congress, ways to address the problem of performance requirements have been considered in legislation concerning international trade and investment such as the Generalized System of Preferences and the Overseas Private Investment Corporation.

Marina Whitman, in an essay published this month, examines the implications for trade and investment theory and policy of recent developments in the world automotive industry. What she very lucidly points out is that international trade and investment patterns in the automotive industry are "fostered not just by competitive pressures but by more and more complex requirements imposed by sovereign governments." She emphasizes further that "most observers believe that patterns of automotive production, trade and investment will in the future be determined at least as much by government policies—including so-called "industrial policy" and the regulatory environment as well as explicit trade policy—as by trends in comparative advantage per se." Among the government policies prominently mentioned are export requirements. Citing her experience at General Motors Corporation for the past 18 months she makes the following comments:

"Our work at GM suggests that what occurs beneath the surface in the day-to-day political and administrative policies and practices of national governments may have greater impact on current operations. In our effort to group countries in terms of degree of risk, it is significant that we have adopted a weighted scale in which 60 percent of a country's score reflects developments in the area of microeconomic policy and regulation."

Dr. Whitman has described an industry for which traditional economic theory and policy are no longer adequate. I would add that an implication of her essay is that traditional institutions like the GATT are not currently addressing situations which she describes. As I will point out later in my testimony, it is in the automotive industry that the most extensive use of trade-related performance requirements are internationally applied. However other industries such as electrical machinery and manufactured foods are also extensively affected. Not surprisingly, both the UAW and the Motor Vehicle Manufacturers Association have begun to give greater attention to these policies used by other countries and are currently in the process of presenting their views on the Mexican automotive decree and U.S.-Mexico automotive trade to the Administration.

LICIT welcomes this discussion and interest in trade-related performance requirements. Such dialogue and debate is a necessary part of working toward a solution to this very complex and difficult problem. LICIT has no illusions about completely eliminating such practices in every industry in all countries. We are concerned about protecting the interests of U.S. companies and workers which may be adversely affected by such practices. For the long term, we will work with the Administration and Congress to assist in reaching an international understanding which would establish limits on the use of trade-related performance requirements and the harmful economic effects they have on other countries.

ECONOMIC IMPLICATIONS OF TRADE-RELATED PERFORMANCE REQUIREMENTS

Trade-related performance requirements are imposed by host-country governments on foreign investors to force their contribution to the trade and industrialization goals of the country where the investment is to take place. Performance requirements can be imposed as a condition of entry for foreign investors or as a condition for receiving investment incentives offered by the host country. At best, these requirements are misguided attempts to manipulate economic conditions through government fiat. At worst, they are transparent attempts to circumvent the internationally accepted rules against discriminatory trade barriers. Government-mandated performance requirements distort the market-determined allocation of goods and capital between countries. Government decisions based upon national economic goals and objectives are substituted for the decisions of private investors based upon international differences in factor costs and prices, technology, and resource endowment.

The most serious new form of trade-related performance requirement is the export requirement, which is unfortunately becoming increasingly commonplace as part of government approvals of foreign investment in a large number of countries.

Export requirements take a number of forms: (1) a company may be required to export a minimum percentage of its annual production (e.g. 30 percent of annual output); (2) a company could be required to meet some absolute export target (e.g. $1 billion in exports over five years); or (3) a company could be required to earn sufficient foreign exchange by exporting to cover all foreign exchange costs of the company's operations.

These trade-distorting performance requirements are a matter of great concern to LICIT because of their serious negative economic effects. By distorting trade and investment flows, they cause a transfer of investment, jobs, and production to the country imposing such requirements and away from that country's trade and investment partners. For example, export requirements force a firm to export a certain amount of its production, irrespective of comparative advantage. Such exports cause trade diversion through displacement of another country's exports to third country markets or through increased imports into the home country from the firm complying with the export requirements. The purpose of these requirements is clear. A host government uses performance requirements to increase its economic welfare, often at the expense of the economic welfare of other countries.

Finally, the increasing use of investment performance requirements in undermining the open international economic environment which has been the object of so much effort over the last 35 years. Performance requirements threaten to undermine the system of agreements and institutions which govern international trade, principally the General Agreement of Tariffs and Trade (GATT). The latest and most ambitious round of multilateral trade negotiations within the GATT framework, the "Tokyo Round" concluded in 1979, was distinguished by the development of several international codes covering non-tariff trade barriers. Investment performance requirements now appear to be the most serious non-tariff distortion to international trade not adequately regulated by international agreement.

INCIDENCE OF TRADE-RELATED PERFORMANCE REQUIREMENTS

The LICIT paper I mentioned earlier provides a good overview of the extent of these practices internationally, and I will summarize that information briefly. It should be noted that comprehensive data on trade-related performance requirements is difficult to obtain because no organization or government systematically collects such information. Also, these requirements are often imposed administratively, on a case-by-case basis, with the details kept confidential between the government and company involved. Therefore the information presented probably understates the actual incidence of these measures.

The LICIT paper on performance requirements identified 17 countries which mandate export requirements. Developing countries comprise the majority of the countries imposing these requirements. However, such developed countries as Canada, Italy, Spain and Turkey also impose such requirements. By manufacturing sector, the incidence of trade-related performance requirements is found most often in the automotive industry. Approximately 40 countries have some form of trade-related performance requirement concerning the production of automotive components and the assembly of motor vehicles.

A new source of data on trade-related performance requirements was just published this June and has yet to be fully analyzed. This is the data from the Benchmark Survey of U.S. Direct Investment Abroad—1977, published by the Department of Commerce. This is the first benchmark survey of U.S. direct investment abroad conducted under the authority of the International Investment Survey Act of 1976 and the only benchmark survey on this topic since 1966. The survey presents data on the extent to which affiliates of U.S. parent companies were subject to trade-related performance requirements of foreign governments. Preliminary analysis of this data indicates a more widespread use of these measures than was reported in the LICIT paper released in March 1981.

This new data shows that 14 percent of U.S.-owned affiliates were subject to at least one type of trade-related performance requirement in 1977. By area, 29 percent of U.S.-owned affiliates in developing countries were subject to these requirements compared to 6 percent of U.S.-owned affiliates in developed countries.

All South American countries except Argentina subjected at least one-third of U.S.-owned affiliates to these requirements. Peru and Venezuela gave such treatment to at least 50 percent of U.S. affiliates. Mexico's percentage was 41 percent. Among African countries, Egypt, Libya and Nigeria imposed such requirements on from one-third to one-half of U.S.-owned affiliates operating there. India imposed these requirements on 60 percent of U.S.-owned affiliates there, the highest level worldwide. South Korea's percentage was 50 percent, while Indonesia, Malaysia, and the Philippines were between 27 percent and 33 percent. Only Hong Kong (2 percent) and Singapore (11 percent) imposed these measures infrequently.

Among developed countries, Portugal and Turkey required 37 percent of U.S.-owned affiliates to comply with some form of trade-related performance requirement. Ireland, New Zealand, and Greece were the next highest at 20 percent.

The benchmark data show that 27 percent of U.S. mining affiliates were subject to these performance requirements and 19 percent of U.S.-owned manufacturing affiliates. Among manufacturing affiliates, 27 percent of those in the transportation equipment sector had to comply with such requirements and 21 percent in the electrical machinery and manufactured foods sectors.

I think it is clear from this summary of data presented in the LICIT paper and the Commerce Department's benchmark survey that trade-related performance requirements are widespread, especially among developing countries, and are being increasingly used by governments to achieve national economic objectives.

THE MEXICAN AUTOMOTIVE DECREE

One of the most elaborate and complex applications of trade-related performance requirements is the Mexican Government's Decree for the Development of the Automotive Industry. I would like to focus on this decree in more detail not only because it is an excellent example of the use of performance requirements but also because it is likely to become a major bilateral economic problem in the near future.

The Mexican Automotive Decree was promulgated in 1977, the latest in a series of government attempts to establish an internationally competitive automotive industry in Mexico. The Mexican Government's objectives are to use the automotive industry to help increase industrial employment and, in the near future, to become a net earner of foreign exchange for the Mexican economy. The automotive decree contains a number of performance requirements to achieve these objectives.

The requirement to export is contained in the decree under foreign exchange obligations. Final assembly enterprises (which include all foreign automobile manufacturers in Mexico) are required to generate a sufficient volume of exports to cover all foreign exchange obligations their operations give rise to. This includes not only the value of direct imports, but also the import content of locally, procured automotive components and indirect foreign exchange costs (e.g. payments made for fees and royalties, interest, travel expenses, insurance and freight charges, etc.). At least 50 percent of the foreign exchange obligation must be met through the export of components manufactured by automotive parts producers, which are required to be at least 60 percent Mexican-owned.

After a delayed beginning, the full effects of the Mexican automotive decree are beginning to become apparent due in part to the increasing restrictiveness of the measures. The initial time schedule for meeting the requirements under the

decree could not be realized because sufficient domestic capacity did not exist in the Mexican automotive parts industry to meet the rapidly increasing demand. The Mexican Government also showed flexibility in enforcing the requirements of the decree in order to allow for the restructuring of the U.S. automotive industry (and its worldwide sourcing) toward smaller, more fuel efficient vehicles. Now that this has occurred sizable investments in parts manufacturing by U.S. companies are taking place in Mexico (approximately $1.5 billion announced or initiated in the past 2 years) in order to meet the export requirements of the automotive decree. When these investments are fully operational (in the 1982-84 time period) the trade effect on the U.S. economy will be sizable.

Mexico is not the only country with such an extensive system of trade-related performance requirements for the automotive industry. Brazil has similar policies for this industrial sector and the Andean Pact countries are beginning to implement the same kind of policies. As I described earlier, however, this is a problem that is international in nature. We seem to be rapidly reaching a crossroads on what can be done about the proliferation of such policies. As trade-related performance requirements become more widespread and integrated into the economic structure of countries around the world, it will be increasingly difficult to stop the spread of these practices and the threat they pose to the present international economic system and the industrial base of the U.S. economy.

RECOMMENDATIONS FOR U.S. TRADE AND INVESTMENT POLICY

U.S. investment policy and U.S. trade policy can no longer ignore this fundamental problem. If effective bilateral and multilateral arrangements cannot be achieved to regulate these measures in the near future, then strong political and economic pressures will build to adopt such policies for the U.S. economy.

We believe that it is significant to the national interest of the United States, as we are the world's largest foreign investor and one of the world's most open markets, to curb the proliferation of trade-related performance requirements. However, we are not alone in being affected by these practices. Developed and developing countries alike suffer from these "beggar-thy-neighbor policies."

The United States has raised the issue of trade-related performance requirements in the OECD and most recently as a proposed new area of consideration in the GATT. Discussions have been held with such countries as Canada and Mexico concerning bilateral problems arising out of those countries' use of these measures. These discussions are useful and necessary and must continue but they are not sufficient. For effective action with respect to trade-related performance requirements, the U.S. Government must develop a more coherent strategy to address these measures on both a bilateral and multilateral basis. This will entail a creative use of both trade and investment policy instruments because trade-related performance requirements affect both trade and investment interests.

The LICIT paper on performance requirements made a number of concrete suggestions that should be given serious consideration. That paper suggested that the improved dispute settlement procedures of the GATT should be utilized to obtain a determination of the inconsistency of trade-related performance requirements with the GATT. In particular, the paper argued that certain types of trade-related performance requirements should be deemed inconsistent with the GATT's rules on national treatment (Article III), subsidies (Article XVI) and state-trading enterprises (Article XVII). It was also suggested that the new Subsidies Code could be invoked to challenge certain types of performance requirements that have the effect of export subsidies. Finally, many trade-distorting performance requirements appear to contravene provisions of friendship, commerce and navigation (FCN) treaties. This is an issue that should also be considered when the United States begins to negotiate bilateral investment treaties with developing countries.

Additional steps could be taken to curb the growth of trade-related performance requirements through the activities of the International Monetary Fund (IMF) and the World Bank Group. These institutions should view such measures as distortions of world trade and investment and as obstacles to economic growth and development. The IMF, in addition to reviewing a country's macroeconomic policies, should also concern itself with microeconomic policies such as trade-related performance requirements and advise against such policies or recommend that they be phased out. Likewise the World Bank Group, especially the International Finance Corporation (IFC), should be directed in their consideration of

specific projects to recommend that such requirements be phased out or abolished if they affect the project under consideration. Finally the U.S. executive director should be directed to take into account the adverse effects on international trade and investment in voting on projects which involve trade-related performance requirements.

I would also like to recommend some steps which could be taken to improve our knowledge of the quantitative dimensions of these requirements. The data presented in the benchmark survey extend the quantity of information previously available on the use of trade-related performance requirements and the extent to which such requirements affect U.S.-owned overseas affiliates. However, it should be possible to improve the quality of information greatly if more extensive analysis of the survey data is undertaken. This could include an analysis of these requirements by country and by industry. If possible, a greater degree of disaggregation of industrial sector information could be presented. Most importantly, it would be extremely useful if quantitative data could be presented on the U.S.-owned affiliate affected by trade-related performance requirements. Such quantitative data could include not only the stock of direct investment affected, but also data on local sales, export sales (including export sales to the U.S. market) and employment. Such data would allow policy-makers to have an accurate quantitative picture of the magnitude of investment and trade being affected by these requirements. Given the importance of this policy issue, the possession of an excellent data source would greatly enhance the ability of U.S. policy-makers to analyze the data on trade-related performance requirements, and propose international actions that the Government should take to begin to remedy this problem.

I would also like to recommend that the study on performance requirements and investment incentives proposed last year by the IMF/IBRD Development Committee Task Force on Private Direct Investment be undertaken as soon as possible. Such a study, funded by the World Bank Group, would be very useful in advancing the state of knowledge of the international effects of these policies.

I hope I have made clear the urgent need for action to address the growing use of trade-related performance requirements. The suggestions for possible actions are not exclusive. They do indicate a greater range of actions which are feasible but have yet to be pursued by the United States. LICIT will continue to give this important economic policy issue our serious attention and thought and urge the Congress and the Administration to do likewise.

Mr. Chairman, that concludes our prepared statement. I thank the Subcommittee for the opportunity to appear before it to express LICIT's views on this important policy issue.

The Chairman. Thank you very much, Mr. Wolff. We appreciate your contribution.

Since we have adopted a kind of free-flowing format this morning and we have interrupted your statements, let me add that, without objection, we will include your written statements as part of our record.

Mr. Wolff's last comment brings me to this next question.

Mr. Bergsten says in his statement that no international rules or institutional arrangements have been developed in the investment area.

Now I said earlier that this was the get-tough Bergsten policy; but what you are really doing there is implicitly criticizing all of the codes and declarations that have been adopted in OECD and in GATT and in the new Subsidies Code.

I take you to be saying that none of these really are explicit enough and tight enough to constitute effective international rules for investment. I wonder if you would care to be more specific about what you see as the defects in the existing arrangement.

Mr. Bergsten. Your interpretation is exactly right, Mr. Chairman. What I meant to say was that some of the existing rules of the game,

such as the Subsidy Code and some of the provisions of the GATT itself can perhaps be used to deal with some of these problems. They were not created with that intent in mind, nor, as Alan pointed out, have they been used in that way. But one could use them. And, as I said in my statement, one should try.

Let me tell you what I think is the fundamental problem with using trade rules to deal with investment problems.

The trade rules apply once trade flows. By definition, that is after hundreds of millions of dollars may have been spent in putting a project together, and thousands of jobs may have been created, and a whole plant and production network is put into place.

If you try to undo the project or react against it at that point, it obviously is much more difficult to do so politically and much more causative of social and economic disruption then if you get at the problem back at its inception, when the investment decision takes place.

This is why, fundamentally it seems to me, to get at these investment-related problems, you have to do so by investment-related policies. I am not saying that you cannot use the existing rules of the game. But I think they are basically inadequate.

The CHAIRMAN. They really are retrospective.

Mr. BERGSTEN. Yes, they are retrospective. They therefore are likely to cause enormously greater problems than would be the case if you hit it head on—hard as that would be—and they are not likely to be effective, because it is so much more difficult to undo something once it has been put into place.

If one agrees that there is a problem with these investment policies per se, one needs to go to the root, namely the investment policies, rather than hit the symptoms that occur down the road in the trade area.

The CHAIRMAN. Now accepting that for the moment, let's move on a little bit to how we would achieve a tighter investment policy.

There is an on-going debate now in Washington, particularly within the administration, as to whether we should go the route of bilateralism or the route of multilateralism. I sometimes think that the bilateralists have the upper hand. Would you support mirror image legislation restricting trade or investment in the United States by countries which apply similar restrictions to U.S. investments, or would you take another procedural approach?

Mr. BERGSTEN. Let me answer your first question first, that concerning bilateral versus multilateral.

I have made several analogies in my presentation to the state of international investment relationships now, with the state of international trade relationships 40 or 50 years ago.

This is another place where that analogy holds.

Remember that U.S. trade policy after the Depression got going through a series of bilateral trade agreements. Mexico was one of the first. There was a whole string of bilateral trade agreements that were worked out between the United States and other countries to try to facilitate the flow of trade.

Eventually it became clear that it was too cumbersome to negotiate bilaterally, even with the much smaller number of countries one had in the world at that time, and that our interest was in most-favored-

nation treatment, generalizing to everybody what you worked out with a given country.

Out of the evolution through bilaterals came the multilateral arrangement which we now know as the GATT.

One could pursue the same evolution. One could go through a series of bilateral efforts with major investment partners, such as Canada, Mexico, Brazil, the Common Market, and Japan.

It seems to me, however, that we should have learned from history that at the end of that road has to come a multilateral arrangement in any event. You do want most-favored-nation treatment. You do want equivalent treatment as much as you can get it among the major trading countries in the market economy world.

So what I am suggesting is that you aim for that multilateral arrangement right at the start. If you could cut through the bilateral stage and go straight to it, I think that would be better. However, as I said earlier, this is an embryonic area and there are particular problems with particular countries, several of which we have mentioned here many times.

So it may make sense in a pragmatic way to try to do arrangements with those major investment partners where there are difficulties—Canada, Mexico, and Brazil, and the Common Market should not be forgotten in all of this—as a starter. Perhaps out of this series then would emerge the multilateral arrangement at the end of the day.

Maybe one should go on both tracks simultaneously. That has been the policy so far, weak though it has been. Maybe that would help each side reinforce the other. I certainly do not rule that out.

As to your second question, whether to retaliate immediately, I certainly would hope we would not have to do that. I think it would hurt our national interests to restrict foreign investment, either outward or inward, and I would hope that other countries would recognize the wisdom of moving into a world where big home countries, like the United States, would not feel compelled to move in that direction.

At the same time, as I said in my statement, I think it is going to be hard to resist pressures in that direction, given the kinds of policies that other host countries, particularly, are increasingly adopting. So, I would not like to see it, but I fear that it may evolve as a matter of political force here in this country unless we can move down the bilateral or multilateral tracks pretty quickly.

The CHAIRMAN. So then you do see today some role for bilateral investment treaties as a means of resolving some of the concerns of the business community.

Mr. BERGSTEN. Yes. I think they could resolve both some of the concerns of the business community about investor protection and some of the concerns about which we have spoken here which, as all the panelists have said, the business community often is reticent to bring forward. Sure, I think bilaterals could help do that.

Let me take a specific case in point which might be relevant.

Alan Wolff made a very important observation when he said that the freer trade becomes, the more likely investment manipulation becomes. When you have written a set of rules in one area, you are trying to beat the sheriff, so you go on to the area that is not regulated. That is what governments are doing.

Where trade has become most free is where some of this manipulation is the most obvious. United States-Canadian auto trade is a case in point. There is basically a free-trade arrangement in the United States-Canada Automotive Agreement. This, therefore, has led to a very rapid scramble through the investment policy area.

Another interesting case is the Common Market itself. The Common Market has freed up all internal trade. So, Common Market member countries have tried to get around that by bringing in investment incentives.

The Common Market has reacted to that. The Common Market has rules limiting the amount of investment incentives that can be offered even in depressed areas of the Common Market, and giving the Commission of the Community authority to reject investment arrangements the particular countries propose that might undermine the free trade objectives of that arrangement.

What happens, in fact, is a complicated bargaining process, where the Common Market, in defending the free trade purpose of that arrangement, does intervene in investment decisions to try to avoid exactly the kinds of things about which we are talking here. They have an ultimate recourse to the European Court of Justice.

If Britain, for example, put on a huge incentive program to move investment out of France and Germany into Wales and did not agree with the European Commission that this was consistent with the purposes of the Common Market, the European Commission could take the British Government to the European Court of Justice. This is in the Treaty of Rome.

Now this never has happened. But the fact that it could happen has been a deterrent to activities of this type.

I think the example of the Common Market, which has developed rules in this area, shows that it can be done. It's tough. The members of the Common Market would be the first to say that these are imperfect rules, that there have been difficulties in implementing them, and so on. But it does show that it can be done and it gives me at least a modest degree of encouragement to think that an initiative in this area is worth undertaking.

The CHAIRMAN. Do you have any comment on that, Chris?

Senator DODD. Yes; thank you.

If you are trying to draft a piece of legislation, maybe we ought to take a look at those Common Market rules. If there were the prospect of some retaliation rather than a piece of legislation which specifically retaliates, we might achieve the best of both worlds. If it became a matter of broad public knowledge in the international community that we were prepared, without getting into specific bilateral country-by-country situations, to take some specific actions if, in fact, investment restrictions occurred, then we might better achieve that result, rather than getting caught up in bilateral arrangements.

Of course, that is easy enough to say and more difficult to draft. I think the point about the Common Market rules is a good idea.

Mr. Wolff, I was intrigued about certain views of the Labor Industry Coalition. Perhaps you already have answered this question—I have the impression that you might have. Is it your view today that we should be promoting U.S. investment overseas? That is a fairly simple question on the surface. What would your answer be?

Mr. WOLFF. Well, our coalition has considered primarily the effects of investment restrictions on trade flows.

We were formed to analyze issues directly affecting trade and U.S. trade interests. So there has been no position taken on direction of investment flows.

I think, however, to comment on the point that was made last, although this has not come up yet for discussion among the members of LICIT, that access to the U.S. market is really the largest bargaining chip the United States has. There is not yet a perceived community of interest. As Fred Bergsten was speaking about a multilateral agreement, a GATT for investment, he noted that it really took decades to come to the point of having a multilateral understanding. It also took a world war and a period of reconstruction, and a very different role for the United States vis-a-vis other countries in that era.

I would guess that it will take us a good, long time to get to a multilateral agreement. In that time, we will have to have some mechanisms that can protect us. Some of the devices will be applied after the fact. When you countervail against a plant that received investment incentives to produce tires in Nova Scotia, shipping them into the United States, where that plant otherwise might have been in the United States, that is after the fact. It causes a lot of adverse reaction abroad, a lot of hostility.

But one has to have unilateral measures, ultimately, as well as a strong effort to resolve matters bilaterally to get at these problems until there is a common recognition that there is a problem. Then multilateral negotiations can take place.

Right now, that common basis does not exist, and a lot of work will have to be done to get us there.

Senator DODD. Does anyone else wish to comment on the question of whether or not we should increase U.S. investment overseas?

Mr. CORS. I cannot add to that because we have not taken a position on that issue.

Senator DODD. I would like to digress for just a minute because I am dealing with another issue in the Banking Committee. But since you are here, I would like to ask your opinion.

We have the Foreign Corrupt Practices Act before us. Senator Chafee has a bill before the committee and we are going to go into markup during September on it. There has been a bit of a delay on it.

One of the provisions in his bill would suggest that U.S. companies comply with the laws of the host country with regard to practices that we may call bribery and which they may call normal business practices in their own country.

It occurred to me as we talked about the tremendous fluidity of host country regulations—I think that Mr. Thomas made reference to this—that you just never know, day to day, week to week, month to month, what the rules are going to be.

Would anyone like to comment on whether or not such a provision would be wise? Do you have any other comments about the Foreign Corrupt Practices Act as a disincentive to U.S. investment overseas; as something that has created or in some way tangentially affected the present climate in the international market for investment?

Mr. WOLFF. The Chafee provision really addresses the fact that if you are in compliance with local law, why should it be the business

of the United States to prosecute you for something that you are doing in that circumstance.

I would just draw one distinction from that in the performance requirements area. We are not objecting to the provision of investment incentives, as such; or, if someone wants to give free electric power; or anything else along those lines; or free training to workers.

The objection really comes when there is a distortion of international trade and there are adverse effects for others, and it becomes a beggar-thy-neighbor policy.

So, in a way there are a number of differences between what the Chafee bill is pointing to and the performance requirements area.

There is a lot of extraterritorial application of U.S. law, however, trying to reach conduct abroad which, personally, I feel is regrettable. In the antitrust area as well there are a number of examples.

LICIT does not have a position on the Chafee bill. I have been active in the U.S. chamber personally on the blll, and hope, with some revisions that are currently under consideration, that it can become law. I think it is an area in which we are encumbering American businessmen with excessive requirements, with overregulation, which is needless and harmful.

Senator DODD. Are there any other comments?

Mr. THOMAS. I have not thought a great deal about the question, but it seems to me that it is certainly a reasonable suggestion.

Senator DODD. Thank you, Mr. Chairman.

The CHAIRMAN. The administration purports to have the 1977 policy statement on international investment under review.

If you were doing the reviewing, what would be your priority recommendations?

Mr. BERGSTEN. Well, I think the objectives laid out in the 1977 policy statement remain correct and supportive of U.S. interests. The question I and others have been raising this morning is whether more vigorous efforts are needed to achieve those objectives in a balanced and equitable and reciprocal way.

The CHAIRMAN. In other words, you would not change the direction; you would just do more of the same?

Mr. BERGSTEN. It is not so much more of the same as first recognizing and then addressing effectively these distortions that have come into the process which undermine the economic logic and basis behind the policy statement and the support for free investment, and also, more directly, the defense of U.S. interests affected by the increasing involvement and manipulation by other countries.

I think it is the new efforts about which we have been talking, in a sense, as necessary to maintain the traditional policy. I think the traditional policy has served U.S. interests. A real question that I have is whether that policy is sustainable for another 5 or 10 years if other countries are playing the game very differently.

Mr. THOMAS. Speaking for the association, I do not think that we have a set of specific recommendations. But we would be happy to and would welcome the opportunity to work with any parts of the Government that were interested in the issue.

The CHAIRMAN. Well, to the extent that we can identify the situs of this review, maybe one of the useful roles of the committee would be to get together with the reviewers.

One of the incentives to performance requirements is the perspective of developing countries that they have some merit in fostering domestic industry, or in reducing trade deficits. From what you have been saying here this morning, that is something of an illusion.

How do you measure the impact of performance requirements on developing countries? How do we educate them in this field?

Mr. BERGSTEN. Let's look at it for a moment as you did, through the eyes of the developing country. As we all have been saying, those countries carry out such policies because they view them as promoting their objectives of job creation, technology inflow, and whatever.

One can think of a couple of cases where they might be justified.

The CHAIRMAN. That was somewhat the 19th century experience of this country.

Mr. BERGSTEN. Yes; it was, and we know about that from our history. And so does Germany and some other industrial countries from earlier periods of their history.

There are at least a couple of instances in which one might defend performance requirements. Suppose a multinational firm, because of its corporate interests, proscribes its affiliate in country X from doing any exporting whatsoever. It would say that its international marketing network is best promoted if its affiliate in that country sells totally to the local market.

Now it may well be that this affiliate could export under normal market forces and inducements. So one could say in that situation that the host country government is responding to the oligopoly power of the firm and really moving back toward what market forces would suggest, and, therefore, its action is defensible.

Another possibility might be the traditional infant industry case. We well know in trade policy that you accept trade restrictions for a limited period of time, if necessary, to get a firm starting at ground zero up to speed from whence he can compete on an economic basis in the world market. An analogous case sometimes might occur here. Consider the minicomputer industry. If the Brazilians thought or had some basis for thinking that with a limited number of years of protection their firms would be able to go out and compete with Data General and other firms in the world market, they would have, in concept, a justification for what they do.

I hasten to say that I think Mr. Thomas is exactly right. When you incubate an industry like that, where the technology is shifting so rapidly, you undermine any prospects for that happening, rather than promote them.

But they could make an argument to that extent.

So, there are a couple of arguments one could make in defense of performance requirements as justified over the longer run.

Aside from that, however, I think experience already is beginning to show that the efforts even subvert the objectives of the host countries themselves. Alan Wolff referred to the Korean experience. The Brazilians themselves, up until about 18 months ago, had a pervasive system of export subsidies, which became so burdensome and so uneconomic that they decided to eliminate them overnight. They have put them back partly now, but they will be phased out again over the next 1½ years.

So, there is increasing evidence, particularly from the field of trade restrictions, but even in the investment area as well, that what you basically get is incubation from market forces, denial of the kinds of competitive pressures that are needed to provide viable industries, and, therefore, domestic economic benefits over time. So, at best, what you are buying is very short-run benefits for your own economy.

The CHAIRMAN. Let me spin this out for 1 more minute.

I said how do we educate developing countries to these long-range effects. That is a kind of condescending thing to say, and I did not mean to sound condescending.

It seems to me, though, that there does have to be a wider recognition of the long-range problem.

Mr. BERGSTEN. I think the consciousness raising that I mentioned earlier in another context is critically important here.

The CHAIRMAN. And that is a part of the educational process.

Mr. BERGSTEN. Yes; exactly.

By beginning to get some transparency into the act, by getting some inventories of how widespread this is, and then by doing some analysis of the effects, one might get the kind of outcome you are seeking.

Remember that the same thing happened in the trade area. It was only two to three decades ago when import substitution was one of the cardinal development strategies carried out throughout the world—primarily in Latin America, but elsewhere as well. The reigning theory said erect import barriers, create industries to serve the domestic market, and over time they will become efficient and able to serve the world market.

In almost every case, this was a total flop. But it took some analysis and experience, some education, and some consciousness raising of the real effects of those policies before the theory could be shot down.

I think we are in the same embryonic stage in the investment area that I mentioned earlier.

Developing countries themselves do not even realize how pervasive this is. Even in my task force of the Development Committee, it was something of an eye opener to the developing countries around the table to learn that everybody else was doing what they were doing, and in the incentive area that they were really just copying each other with no little possible net benefit.

In the performance requirement area, knowledge is not even that widespread.

So, I think shedding a lot of light on this has to be the first step. It would serve your purpose as well as the purpose of understanding how distortive it is to the world economy and therefore the need for some international action.

Mr. THOMAS. I agree totally with Fred on this point.

If you look at the situation in Brazil, from our viewpoint the evidence shows that the minicomputer model, which is in its 4th year in that country, is totally unsuccessful. The product is obsolete technologically. It is not competitive costwise.

In another instance, I was in the Philippines 2 weeks ago, talking to businessmen there, who told me that the Volkswagen kits that

were being imported in the Philippines from Brazil were going to cease. The dealer, distributor, and assembler there were switching to another manufacturer because of the same reasons—it was technologically outmoded and the cost was high.

Mr. WOLFF. It seems to me that beggar-thy-neighbor policies can work so long as your neighbors are not following the same policies and as long as it does not impair your technological progress. The unfortunate thing for the developing countries is that I don't think the schemes work. You can channel the development. But you have to believe that bureaucrats are a better controlling force for the economy than the marketplace. What has happened to minicomputers in Brazil happened to minicomputers in Japan as well a few years back. They cut back their own development by inhibiting access to their own market.

But it will take a while to get people to realize that the policies are counterproductive.

The CHAIRMAN. Chris, do you have any further questions?

Senator DODD. No; Mr. Chairman, thank you. But I do want to compliment our panel. I think the testimony has been excellent this morning. It has been really worthwhile and helpful. My hope is that we can do some of what you suggested, Mr. Chairman, and make this a higher profile issue. I think some excellent points have been raised. Hopefully more people who are doing business overseas will feel more comfortable about speaking out.

I can understand fully the trepidation that some feel about potential repercussions for raising their voices about some of the performance requirements they have to go through. But silence is not getting us anywhere, and if we can generate some real interest in Congress over this I think we can take some intelligent steps.

I had an experience a week or so ago in my home State of Connecticut, where I met in Fairfield County with a group of chief executive officers of some of the largest corporations in this country. That particular area of my State has the second largest collection of Fortune 500 corporations, second only to lower Manhattan. It was an eye opener to hear people whom I have known for some time spend almost the entire 1½ hours talking about this particular problem, despite the fact that we had a tax bill before the Congress at that time. This still was the issue about which they wanted to talk. This was the thing that they found tremendously restraining.

I repeat, these are major corporations. So I am sure smaller businesses are even more reluctant to talk about it, given their more vulnerable position vis-a-vis some of these countries.

I really appreciate your testimony today. Thank you all for coming.

Thank you, Mr. Chairman.

Mr. BERGSTEN. Senator, may I say that the committee already has struck a small, but I think important, blow in this area by adopting amendments that the chairman submitted to the OPIC legislation, which would clearly indicate the disapproval of the United States of these incentive and performance requirement practices. I certainly would hope that those amendments would survive on both the Senate floor and in the eventual reconciliation with the House.

Senator DODD. You know, a lot of you people don't have to wait for us in the Congress. If you have some ideas in this area legislatively,

when things are coming up, be they tax treaties or other bills—and I will speak for myself in this case—please do not be reluctant about coming to us with an idea. If it is a bad one, I will tell you so. But I would rather have the ideas and the suggestions.

We cannot just rely on our own staffs. I would hope that you would feel comfortable about being in touch with us on things such as this. Whether they are bilateral or multilateral, they can really be of very helpful assistance to you.

Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. In line with the comments of the Senator from Connecticut, there is an increasing awareness of this problem. I believe that the awareness will grow as the economic interdependence of the world increases and increases at an accelerating rate. As the volume of trade increases all over the world, these issues will become increasingly important.

It would be the hope of this committee that, for once, the Congress will get ahead of the problem and does not have to try to deal with the problem after all of the damage has been inflicted and it becomes a damage control operation instead of a damage prevention operation.

Senator DODD. It would be a first, but it would be interesting.

[General laughter.]

The CHAIRMAN. Well, it shows you that I am an ingrained optimist, the thought that we could try to do that. But that is our hope. With the help of all who are gathered here at the witness table, maybe we can have some modest degree of success.

Before I close the hearing, I want to put into the record a statement on performance requirements. This is "A Study of the Incidence and Impact on Trade-Related Performance Requirements, and an Analysis of International Law." This comes to the committee from the Labor-Industry Coalition for International Trade.

We accept that with our gratitude.

[The information referred to follows:]

PERFORMANCE REQUIREMENTS

A Study of the Incidence and Impact of Trade-Related Performance Requirements, and an Analysis of International Law

LICIT

The Labor-Industry Coalition for International Trade

March, 1981

Foreword

This paper is being published by the Labor-Industry Coalition for International Trade, LICIT, a group of industrial unions and corporations that seek to represent the common interests of American workers and American business in promoting increased, balanced and equitable international trade. Without reference to outdated slogans of "free trade" and "protectionism," LICIT supports adoption of government policies and industry practices that encourage open, fair competition for foreign products in the United States market, as well as for American-made products in foreign markets.

The Coalition is a voluntary association representing two of the primary forces in the U.S. economy. It is not an official arm of any labor or industry group. The Coalition provides a forum in which government leaders responsible for trade policy may exchange views with those affected by decisions of the Federal Government.

This paper's objective is to increase the awareness on the part of public officials, labor and business of the growing problem of trade-related performance requirements. It is hoped that this effort will lead to a consensus on the need to address this critical problem which threatens the integrity of the international trading system and the health of important parts of our own economy.

Special recognition for their work in preparing the economic analysis in the paper goes to Stanley Nehmer and Christopher Mark of Economic Consulting Services, Inc. The legal analysis was prepared by R. Michael Gadbaw of Verner, Liipfert, Bernhard and McPherson. Labor and industry contributions to this paper were coordinated by Brian Turner and Allan Cors, respectively.

The views described in this paper are not necessarily those of any individual LICIT member. However, all of the members of LICIT believe that the analysis provided here will be an important contribution to efforts to deal with the serious problems created by trade-related performance requirements.

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March 1981

Labor-Industry Coalition for International Trade

MEMBER ORGANIZATIONS

Allegheny Ludlum Steel Corporation

Amalgamated Clothing and Textile Workers Union

Communications Workers of America

Corning Glass Works

International Brotherhood of Electrical Workers

International Union of Electrical, Radio and Machine Workers

Industrial Union Department, AFL-CIO

Ingersoll-Rand Company

International Ladies' Garment Workers Union

International Association of Machinists and Aerospace Workers

St. Joe Minerals Corporation

United Steelworkers of America

The Boeing Company

W. R. Grace & Company

Westinghouse Electric Corporation

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Executive Summary

Preoccupation with other forms of trade barriers——tariff and non-tariff——has left untouched an increasingly prevalent form of protectionism commonly referred to as performance requirements. Trade-related performance requirements are measures which governments employ to ensure that incoming investments serve particular national objectives. At best, these requirements are misguided attempts to manipulate economic conditions through government fiat. At worst, they are transparent attempts to circumvent the internationally accepted rules against discriminatory trade barriers.

A survey of performance requirement practices demonstrates that virtually every major trading partner of the United States imposes some form of performance requirement on at least some local affiliates of foreign corporations. Both developing and developed countries have embraced trade-related performance requirements as a means of dictating to foreign-owned firms actions which would not, absent coercipn, be taken in the course of sound business planning. These actions might include giving commitments to export a specific quantity, incorporate a specified amount of local content, or offset the firm's imports by its exports.

To cite the automobile industry as just one example, over 40 countries impose local content rules or other trade-related performance requirements on companies that seek to sell vehicles in their countries. The widespread impact of these measures in the automobile sector has created pressures in the United States for strong action to dismantle these damaging foreign practices or, as an alternative, to adopt similar measures in this country.

Trade-distorting performance requirements are a matter of great concern because of their serious negative economic effects. They result in a direct transfer of investment, jobs and production to the country which imposes them——and away from other countries. The international shifts in investment, employment, production and trade which they cause are not a response to market forces. Rather, they are the result of government fiat. Their purpose is to increase the economic welfare of the country imposing such measures directly at the expense of other countries——a new form of beggar-thy-neighbor policy. Balance of payments pressures brought on by ever-increasing oil import bills could well lead to a more widespread use of such measures. Such government-directed economic decisions not only injure other countries, they also result in the misallocation of resources internationally, with predictably adverse consequences for efficiency, inflation, and employment.

As the volume of international investment increases, the degree of government intervention typified by trade-related performance requirements is certain to have an even greater impact in offsetting normal market forces and distorting national economies. Distortions feed on distortions and ultimately every country could be forced to adopt policies designed to protect domestic employment and industries against these foreign unfair practices.

An especially disturbing impact of performance requirements is the undermining of the open international economic environment which has been the object of so much effort over the last 35 years. Through international agreements such as the General Agreement on Tariffs and Trade (GATT), the United States and its trading partners have agreed not to use governmental regulations as a means of discriminating against imports in favor of domestic production except under specific conditions where serious injury has been caused to a domestic industry. Without adherence to this important principle, in all measures affecting trade, the progressive elimination of tariff and non-tariff barriers would be meaningless. Unregulated practices, such as trade-related performance requirements, are thus undermining the system of fair and open trade established under the GATT.

Neither the letter nor the intent of the GATT permit such a result. A review of the trade-distorting performance requirements——such as local content requirements and export commitments——in light of the GATT rules indicates that the rights granted by the GATT are infringed by such practices. In particular, performance requirements should be deemed inconsistent with the GATT's rules on national treatment (Article III), subsidies (Article XVI), and state-trading enterprises (Article XVII). Furthermore, the new Subsidies Code can be invoked to challenge certain types of performance requirements that have the effect of export subsidies. Finally, many trade-distorting performance requirements appear to contravene provisions of friendship, commerce and navigation treaties.

The United States should not hesitate to pursue the remedies available under international agreements to challenge these unfair, discriminatory practices. There must be no reluctance to challenge these practices despite the claims made by foreign governments that these measures are politically sensitive and necessary. If we fail to act, we may, through silence, legitimize these practices, and thus contribute to their proliferation.

The U.S. Government should not wait for a specific complaint to be filed from private parties. This approach will not suffice. Private parties often must accept economic conditions as they find them. Companies must make the judgment whether to accommodate themselves to local practices or refuse to invest. Most companies make the understandable judgment that confronting a foreign government by bringing a complaint will only result in damaging their own commercial prospects and giving their foreign competitors an unwarranted market advantage.

What is needed is recognition that the issue of performance requirements should now be given high priority in U.S. trade policy formulation and placed on the agenda for international negotiation. The remedies available in international agreements should be pursued.

Our trading partners should be reminded that the survival of an open trading system is based on the maintainence of reciprocal access to markets. Let no one doubt that the United States will take whatever actions are required to curb the use of measures which undermine the global system of fair and open trade.

I. Introduction

1

Performance requirements are imposed by governments to ensure that incoming direct investments serve particular national objectives. Especially prevalent since 1960, they now exercise a pervasive influence on international investment patterns, and substantially distort international flows of trade and capital. Trade-related performance requirements——requiring minimum local content or export levels——now constitute one of the most serious trade policy problems facing the international trading community. They are especially urgent for the United States, as they are a new and uncontrolled form of beggar-thy-neighbor policy imposed by many countries but not used by our Government.

This paper begins the process of assessing the incidence of performance requirements and their economic implications, and addresses the remedies available under international law to deal with this growing problem.

The Problem

Trade-related performance requirements have the same potential to distort national comparative advantage as tariff and non-tariff barriers, such as discriminatory product standards and export subsidies. From the Smoot-Hawley levels of 1930, tariffs have been lowered dramatically over the past 50 years through a series of international negotiations. The most recent of these, known as the Tokyo Round of Multilateral Trade Negotiations (MTN), for the first time addressed substantially the problem of non-tariff barriers. Trade-related performance requirements were not considered in these negotiations, however, and the MTN codes do not directly address the use of performance requirements. Nevertheless, the effectiveness of reduced tariffs and the new non-tariff barrier codes, including those governing subsidies, dumping, and government procurement——the result of years of difficult negotiations between the United States and other trading countries——are being undermined by the increasingly widespread use of performance requirements. Particularly in developing countries, but also increasingly in the industrialized countries, firms with foreign equity and management participation are subject to a variety of official policies and procedures designed to force their contribution to the host government's trade and industrialization goals.

The effects of these requirements on global patterns of investment, trade, and employment are already having a significant impact on the economic interests of the United States as the world's principal trading and investing nation. But the pernicious effects of these measures leave no country unharmed. Their purpose is to alter the international flows of trade and investment and to gain production and employment at the expense of communities and workers in other countries.

While investment issues are extremely difficult to address internationally, because they frequently reflect highly politicized national policies, the international trading community can no longer afford to ignore these measures.

1 Other forms of investment requirements, such as those limiting remission of profits abroad or forcing technology transfers, may indirectly have trade-distorting effects, especially if they are applied in conjunction with minimum export or local content requirements. Furthermore, a number of fiscal or administrative incentives may be brought to bear in such a way as to substitute for or amplify the more "visible" trade distorting performance requirements. At the risk of over-simplification, however, these ancillary restrictions and incentives will be treated as if they were implicit in the two forms of requirements being considered. A much more detailed and comprehensive analysis will be required to identify the precise significance of various investment policy tools on international trade patterns

The Measures Employed

Trade-related performance requirements fall into two general categories: (1) export performance requirements, and (2) local content requirements.

Export performance requirements are commitments imposed on an investing firm to export a fixed percentage of production or to export a specified minimum quantity of the goods produced. Such requirements distort trade by artificially increasing exports above levels that would have prevailed in the absence of the government intervention. They, therefore, function like an export subsidy by artificially increasing supplies to world markets over levels which market forces would dictate.

Local content performance requirements specify that a given percentage of the value of the final output must be obtained from local sources or produced locally by the foreign investor. These local sourcing or value-added requirements are similar in their effects to a tariff or import quota.

Additionally, firms may be required not to incur any foreign exchange costs, and as a result they must balance their imports and exports. This requirement involves a combination of the above two categories in that it causes firms to increase exports and/or decrease imports by adding more value locally.[1]

Performance requirements may be enforced in a variety of ways. Investments which do not comply may be excluded from a country altogether or they may be made subject to various types of penalties. Conversely, many countries offer extensive incentives to investors who are willing to comply with performance requirements. These incentives also distort trade and investment patterns. Moreover, they are inflationary insofar as they cause production facilities to be located in a country which is not even potentially the most efficient location for that production.

The purpose of these policies and measures is clear: to increase exports and reduce imports. The effects on others are less immediately apparent. They work to reduce the export potential (and increase import dependence) in other countries, weakening the industries where major foreign incentive programs exist. Performance requirements are thus a new tool of the old, discredited policy of mercantilism.

Performance requirements may take one of three forms: (1) statutory, (2) regulatory (contained in various public administrative documents) and (3) covert or informal (these requirements are implemented as a matter of policy although they are not published). Covert performance requirements are difficult to measure or document since the corporations which are asked to comply with them generally regard these requirements as confidential matters which if disclosed could compromise good relations with the host government and threaten marketing and investment strategies.

This paper cannot offer a comprehensive review of all trade-related performance requirements, in all countries, or of all possible remedies to this growing problem. It is an effort to assess the problem and raise it to the prominence it deserves in discussions of trade policy in the United States and internationally. It should be seen as a first step in coping with what may become the major trade barrier of the 1980s.

II. Incidence of Performance Requirements for Direct Investment in Foreign Countries

Extent and Nature of Performance Requirements

Nearly all the major trading partners of the United States impose some form of performance requirements on at least some local affiliates of foreign corporations. This fact is documented in the summary of available information on investment performance requirements imposed by foreign countries, although the data are still incomplete and sketchy. See Tables 1 through 3. About ten percent of the overseas affiliates of U.S. corporations report being affected by such policies, but their incidence is much more pronounced in the developing countries, particularly in Latin America. Three to four percent of affiliates in developing countries have reported export or import requirements, while about one percent of affiliates in developed countries report being subject to them.

While these proportions might seem small, it must be assumed that many requirements are never reported insofar as they result from unpublicized arrangements between investors and host-country officials; once established in a given country, investing firms will normally avoid actions which may antagonize local authorities. Furthermore, the economic significance of any given requirement is difficult to assess precisely, since it will depend on the volume of production accounted for by any given affiliate, and on the competitive structure of the sectors within which they operate.

Examples of Trade-Distorting Performance Requirements

a. Local Content Requirements

Illustrating the nature of the various investment performance requirements, the following examples of some foreign countries' local content requirements are representative:[1]

ARGENTINA - local content required for auto and tractor producers.
BRAZIL - 50 percent local value-added required for special financing for minerals development; incentives to auto producers linked to progressive increases in use of locally produced parts.
CANADA - investment approvals and Federal incentives linked to local sourcing commitments administered by the Foreign Investment Review Agency.
GREECE - investment approvals conditioned on local content, on case-by-case basis.
INDONESIA - local content requirements in auto industry.
ISRAEL - incentives linked to production with more than 25 percent local value-added; special grants for purchase of machinery with 50 percent local content.
KOREA - local content requirements may be imposed for investment approval; guidelines for 100 percent local content for auto manufacture.
MALAYSIA - tax incentives conditioned on high local content; specific local content requirements for auto assemblers.
MEXICO - tax incentives conditioned on 60 percent local content; specific requirements for local content in auto industry.
NETHERLANDS - local content requirements occasionally for public and semi-public projects in high-technology areas.
NORWAY - local content requirements in North Sea oil projects.
PERU - mandatory local content requirements in auto industry.
PHILIPPINES - local content requirements on case-by-case basis; specific local content requirements in auto and electronics industries.
SPAIN - performance requirements frequently negotiable; use of local materials required in some cases.
TAIWAN - local content requirements for telephone equipment, TVs, autos.
TURKEY - minimum local content requirements.

b. Minimum Export Requirements

The following are reported examples of performance requirements related to level of exports:[2]

BELGIUM - various incentives linked to exports.
BRAZIL - commitment to export at least 50 percent of mineral output, as requirement for special financing; other incentives linked to 10 percent annual increases in exports.
CANADA - specific export commitments required on case-by-case basis under Foreign Investment Review Act.
GREECE - specific export commitment required in some cases, with penalties for failure to meet requirements.
INDIA - incentives provided to firms exporting at least 25 percent of output.
ISRAEL - incentives linked to 20 to 50 percent production for export; some grants and loans tied to export performance.
KOREA - investment approvals linked to level of exports; specific export requirements for export-import link system.
MALAYSIA - tax incentives linked to degree output is exported.
MEXICO - incentives conditioned on level and nature of exports; specific export requirements for manufacture of auto products.
NEW ZEALAND - special grants conditioned on achieving specific export levels.
PHILIPPINES - several incentive programs linked to degree of production for export; 50 percent export level sometimes required under Export Priorities Plan.
SPAIN - performance requirements frequently negotiable; specific export levels required in some cases.
TAIWAN - tax incentives tied to minimum export volumes.

Performance Requirements in the Automotive Industry

Due to the size of the projects involved and the publicity surrounding investment decisions, the automotive sector offers some of the best examples of the prevalence of national investment programs which change patterns of plant location. The incentives offered are often the carrot needed to encourage private investors to accept performance requirement obligations:

- In 1978, Canada paid the Ford Motor Company $68 million to build a plant in Ontario (a leading alternative was Ohio).
- Last year, France reportedly offered Ford in the neighborhood of $400 million to locate an automotive assembly plant in Alsace-Lorraine as it bid against other countries for a project that eventually was abandoned.
- Nigeria has offered $70 million in equity and loans to British Leyland.

1 Derived from the sources cited in Tables 1-3.
2 Ibid

- Within the United States, local tax and other incentives amounting to $80 million were extended to Volkswagen for its Rabbit assembly plant in Pennsylvania.
- The Mexican Automotive Decree, discussed below, combines investment incentives and performance requirements in a highly discriminatory manner. (See Appendix B.)

The use of financial incentives to alter patterns of investment already includes an implicit performance requirement: Production will henceforth take place in the host country that might otherwise have been placed in another country. But the granting of incentives is rarely unaccompanied by an understanding (usually formal, if unpublicized) of the degree to which production will be exported or will include local content.

a. The Mexican Auto Decree of 1977

As an example of one country's performance requirements, the Mexican Decree for Development of the Automotive Industry, promulgated in 1977 and scheduled to take full effect by 1982,

Table 1

Performance Requirements for[1] Foreign Direct Investment In Selected Countries

PERFORMANCE REQUIREMENTS BASED ON DOMESTIC ECONOMIC CONSIDERATIONS

Location in development areas	*Local content requirements*	*Technology transfer considerations*	*Restriction of foreign investment in certain sectors*	*Encouragement of foreign investment in priority sectors*	*Limitations of foreign acquisition of domestic firms*	*Limitation on size of new investment projects*
Austria	Algeria	Belgium	Argentina	Brazil	United Kingdom	Spain
Belgium	Argentina	Brazil	Austria	Belgium	France	Taiwan
Brazil	Australia	Canada	Denmark	Finland		
Denmark	Bolivia	India	Japan	West Germany		
Finland	Brazil	Israel	Korea	Israel		
France	Canada	Portugal	Nigeria	Italy		
West Germany	Chile		Sweden	Mexico		
Israel	Colombia		Switzerland	Malaysia		
Italy	Egypt			Philippines		
Korea	France			Switzerland		
Malaysia	West Germany					
Netherlands	Greece					
Philippines	India					
Sweden	Indonesia					
Switzerland	Israel					
United Kingdom	Kenya					
	Korea					
	Malaysia					
	Mexico					
	Netherlands					
	Nigeria					
	Norway					
	Peru					
	Philippines					
	Portugal					
	Singapore					
	Spain					
	Taiwan					
	Tunisia					
	Turkey					
	Uruguay					
	Venezuela					

1 These performance requirements vary in severity from country to country, they may be absolute requirements for all foreign investment in the country, requirements under specific incentive programs or generally encouraged policies. They may apply to all investment or specific industries.

Sources U S Department of Commerce *Incentives and Performance Requirements for Foreign Direct Investments in Selected Countries*, (1978) and *Overseas Business Reports* for various countries; Chamber of Commerce of the United States, *Investment Incentive Programs in Western Europe* (1978); Business International Corp., *Investing Licensing and Trading Conditions Abroad* (various issues, for various countries)

Table 2

Performance Requirements[1] for Foreign Direct Investment in Selected Countries

FINANCIAL PERFORMANCE REQUIREMENTS

Foreign firm required to put up a certain amount of own capital	*Local equity participation requirements*	*Limitations on borrowing*	*Limitations on remittances abroad*
Argentina	Canada	Denmark	Egypt
Belgium	Egypt	Ireland	Finland
Brazil	Greece	Italy	France
France	India	New Zealand	Greece
Netherlands	Indonesia	Peru	Mexico
Portugal	Ivory Coast	Spain	Peru
Turkey	Japan		Portugal
	Korea		Taiwan
	Malaysia		Turkey
	Mexico		
	New Zealand		
	Nigeria		
	Norway		
	Peru		
	Philippines		
	Turkey		

MANPOWER PERFORMANCE REQUIREMENTS

Job creation	*Registration and/or limitation of foreign employees*	*Training of local employees*	*Management participation*
Belgium	Brazil	Belgium	Denmark
Brazil	France	Ivory Coast	Switzerland
Canada	Finland	Portugal	
Denmark	Indonesia		
W. Germany	Mexico		
India	Netherlands		
Italy	Nigeria		
Ivory Coast	Peru		
Malaysia	Switzerland		
Mexico	United Kingdom		
Philippines			
Portugal			
Sweden			

1 These performance requirements vary in severity from country to country; they may be absolute requirements for all foreign investment in the country, requirements under specific incentive programs or generally encouraged policies. They may apply to all investment or specific industries

Sources: *U.S. Department of Commerce: Incentives and Performance Requirements for Foreign Direct Investments in Countries*, (1978) and *Overseas Business Reports* for various countries; Chamber of Commerce of the United States, *Investment Incentive Programs in Western Europe* (1978), Business International Corp., *Investing, Licensing and Trading Conditions Abroad* (various issues, for various countries)

includes both local content and minimum export requirements.[1] The Government of Mexico has estimated that the decree will have the effect of raising exports of Mexican auto parts from $650 million in 1979 to over $5 billion by 1985. Some 60 percent of the increased Mexican exports will be directed to the U.S. market. This represents the equivalent of 86,000 to 115,000 jobs in the U.S. auto and auto parts industries.

1 Mexican Government intervention in autos began in 1962 with a program that combined import restrictions with local content rules. The next step was taken in a 1972 decree that required firms to match imports of parts and equipment with exports of automotive products. Tax incentives were also included to encourage exports. A 1977 decree further refined these requirements, tightened local content and export requirements, and expanded the use of export and domestic subsidies. A 1980 decree is designed to extend and refine the system of incentives and controls over the parts and components industry. See Appendix B for a more detailed exposition of the auto decree

The Mexican auto decree's stated objectives involve accelerating the growth of the Mexican automotive industry and assisting the industry to become a net exporter within five to ten years. Similar measures reportedly are also under consideration in Mexico for the textile, steel, petrochemical and other sectors, depending on the experience with the auto decree.

The Mexican regulations are complex and will affect firms differently, depending upon such factors as current local content, model types, export levels and investment plans. Local content requirements have been set initially at 50 percent for each motor vehicle model but are "recommended" to rise to 75 and 80 percent for autos and trucks, respectively, by 1981. Failure to meet recommended levels will result in increased export requirements.

None of the seven companies engaged in assembly of automobiles in Mexico is able to operate at minimum efficient scale because of the limited size of the Mexican market. Minimum efficient scale for assembly of subcompact cars is estimated to be 150,000-200,000 vehicles a year. In contrast, in 1979 the number of autos assembled by each company in Mexico, combining all models, was far below minimum efficient scale.

Table 3

Performance Requirements for Foreign Direct Investment in Selected Countries

BALANCE-OF-PAYMENTS REQUIREMENTS

Level of exports	*Import substitution considerations*	*General effect on balance of payments*
Belgium	Brazil	Mexico
Brazil		Portugal
Canada		
Greece		
India		
Israel		
Italy		
Korea		
Malaysia		
Mexico		
New Zealand		
Philippines		
Portugal		
Singapore		
Spain		
Taiwan		
Turkey		

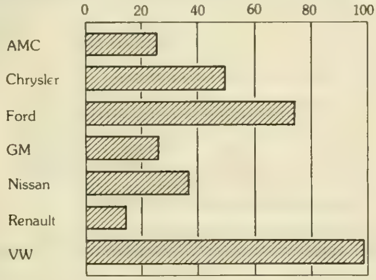
OTHER PERFORMANCE REQUIREMENTS

Language	*Health safety environment*	*Real estate and construction restrictions permit requirements*
Canada	Canada	Finland
	Denmark	France
	Greece	W. Germany
	Israel	Greece
		Korea
		Switzerland
		United Kingdom

1 These performance requirements vary in severity from country to country, they may be absolute requirements for all foreign investment in the country, requirements under specific incentive programs or generally encouraged policies. They may apply to all investment or specific industries

Sources. U.S. Department of Commerce: *Incentives and Performance Requirements for Foreign Direct Investment in Selected Countries*, (1978) and *Overseas Business Reports* for various countries, Chamber of Commerce of the United States, *Investment Incentive Programs in Western Europe* (1978), Business International Corp, *Investing Licensing and Trading Conditions Abroad* (various issues, for various countries)

Number of Autos Assembled in Mexico, 1979
(Thousands)



Operation at suboptimal scale in the automotive industry entails substantial additional costs. Local content requirements add to the inefficiency of operation.

The Mexican National Commission on Foreign Investment has wide discretion to promote Mexican investment and regulate foreign investment to take into account "the incorporation of domestic inputs in components" in determining "the advisability of authorizing foreign investment and in fixing the percentages and conditions by which it will be governed." New investment may include plant expansion or relocation, new product lines, and increasing capital. The Commission's powers are often used to require local content before a new foreign investment is authorized, the result of a "bargain" between the foreign investor and the Commission.

The trade effects of the decree will include: (1) reduced sales of U.S. auto parts to Mexico; (2) reduced U.S. sales of vehicles to Mexican free zone areas, and (3) increased shipments of Mexican parts to the United States. Mexican exports to the U.S. will also be increased to the extent that U.S. automobile manufacturers operating in Mexico choose to export instead of utilizing a greater

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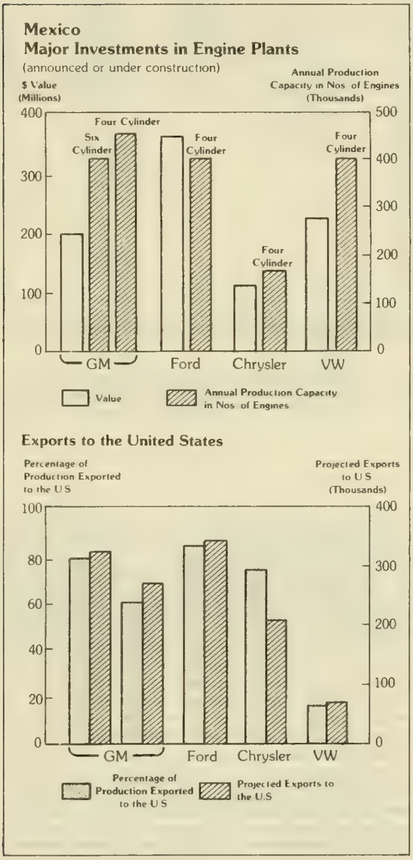
degree of local content. Thus, the combined impact of the automotive decree's provisions will cause substantial losses to U.S. automotive suppliers, workers and communities in the form of lost sales, investments and jobs.

The changes in investment patterns and trade flows brought about by the Mexican decree will become fully apparent only over time. Imports from Mexico of four-cylinder piston engines, engine parts, automotive glass, castings and forgings, electrical parts and subassemblies, and perhaps even finished compact cars are expected to increase dramatically over the next five years.



Indeed, it is estimated that U.S. imports of automotive products from Mexico will increase on average at a rate of 30 to 40 percent while U.S. exports to Mexico will rise only 10 percent annually.

b. The Brazilian Auto Industry Program

As another example, Brazil's regulations differentiate between automobile manufacturers with a Brazilian Government-approved export program and those without such a program. According to U.S. Government analyses, companies with an export program are favored and allowed a lower level of local content by value. The required local content by value is 78-80 percent for trucks, 82 percent for utility-type vehicles, 85 percent for passenger cars, and 95 percent for "Jeep-type" vehicles. Manufacturers with no approved export programs are required to manufacture vehicles with a 95 percent local content. Imports of parts and components from Latin American Free-Trade Area (LAFTA) nations that assure reciprocal terms to Brazil are treated as being of Brazilian origin as long as they do not constitute more than 5 percent of the value of the content of the vehicle. Thus, Brazil's performance requirements discriminate against other developing countries, as well as against U.S. investors and exporters.

The leading example of the impact of Brazil's policies can be seen in the history of Volkswagen, the largest car manufacturer in Brazil. In 1978, VW (Brazil) exported 64,000 vehicles, two-thirds of the industry's total exports, to markets in Algeria, West Germany and Nigeria. VW is now investing $600 million in production of water cooled and alcohol engines, many of which will be exported to the United States. In order to receive permission to import essential plant and equipment without heavy tariffs, VW (Brazil) has had to accept a 50 percent increase in its export commitment.

National Investment Review Programs

a. The Case of Canada

The Government of Canada is probably the most assertive advocate of the benefits of performance requirements. Through the Foreign Investment Review Agency (FIRA), all new foreign investments and acquisitions of existing ventures must be approved as providing substantial benefits to Canada. Each year FIRA publishes an annual report in which it documents in considerable detail the extent to which it has successfully imposed trade-distorting performance requirements on foreign investors, the largest single group of which come from the United States.[1]

In its first five years of operation, FIRA received 2,089 investment proposals of which 1,613 or 77 percent were judged to offer significant benefit to Canada and were, therefore, approved. This relatively high approval rate does not mean that FIRA's review is perfunctory. As the Honorable Herb Gray, head of FIRA, explained to an audience last August,

> *...the Government's object in establishing FIRA was not simply to permit blocking of foreign investments but also to negotiate the matter of benefits as part of reaching decisions on a transaction. Indeed, most of the work performed by the Agency centers on the effort to improve original proposals and to negotiate additional firm commitments that will be beneficial to Canada.*

There is little doubt that many of these commitments involve import substitution and export commitments. According to FIRA,

1 See, e.g., "Foreign Investment Review Act; Annual Report 1978-79."

export commitments were obtained in 37 percent of allowed acquisition proposals and 32 percent of allowed new business proposals.[1] This commitment can take a variety of forms including a specific export target expressed as a percentage of output or sales. Similarly, import substitution commitments can take the form of an undertaking to purchase in Canada a minimum percentage of total requirements of specified products.

As a leading recipient of foreign investment and a major trading partner of the United States, Canada sets an example for the rest of the world whose adverse consequences should not be underestimated.

b. The Case of Australia

The Government of Australia applies restrictions on foreign investment at both the Federal and State levels. The Federal Government screens acquisitions of companies with assets over $1 million where 15 percent or more of the voting shares will be acquired by a foreign investor. Such acquisitions require full disclosure and approval from the Government. The standard applied by the Government requires that the net economic benefits, direct and indirect, of the investment be sufficient to justify the increased degree of foreign control of the industry in question.[2]

1 See "Foreign Investment Review Act; Supplement to the 1978-79 Annual Report." at p.5.

2 See "The Adequacy of the Federal Response to Foreign Investment in the United States; Twentieth Report by the Committee on Government Operations." House Report No. 96-1216, August 1980 at p. 155.

III. Economic Implications of Trade-Distorting Performance Requirements

Countries imposing trade-related performance requirements base their policies on rationales which, upon examination, fail to justify the distortions caused by performance requirements. While internal political considerations may seem to make performance requirements both a necessary and a convenient means of controlling the activity of foreign investors, the longer-range consequences are likely to be as damaging to the host country as they are for other countries and the international trading community at large.

Performance requirements are sometimes defended, for example, as being necessary to counteract anticompetitive practices by foreign-owned firms operating within their territories. However, the use of performance requirements for such purposes will probably lead itself to other distortions in host-country economies. Specific anti-competitive practices can be dealt with more effectively through enforcement of local tax and antitrust laws——e.g., by requiring for intrafirm transactions transfer prices that are demonstrated to be reasonable approximations of an "arm's-length" price.

Because performance requirements constitute barriers to entry, they serve to restrict competition rather than to enhance it. Export-related requirements in effect protect existing local industries from the full extent of competition that would otherwise have been introduced by foreign-operated firms. Local content requirements also protect local producers from more efficient competitors overseas. The long-run consequences of such requirements, therefore, are likely to involve the entrenchment of oligopoly power in host-country industries. From this viewpoint, the approach to be preferred would be the reduction of trade and investment restrictions, coupled with strict enforcement of tax and antitrust laws to maximize competition.

Performance requirements are also rationalized as necessary to force the transfer of technology, thus accelerating development of potential comparative advantages. Coupled with local content requirements, they may be designed to promote the development of local production and distribution networks thought to be necessary for the emergence of a fully competitive sector. Minimum export requirements may be intended to steer investment into sectors in which the host country believes it could become competitive internationally.

In practice, however, when entire sectors of the economy are protected in this wholesale fashion, national resources are clearly misused. Inefficient production eventually comes to burden the economy--through higher prices, implicit or explicit continuing subsidization costs, or retarded growth, offsetting gains from "accelerated" development in potentially competitive sectors. The imposition of performance requirements presumes that host-country government officials are able to dictate shifts in comparative advantage——indeed a rare ability. Furthermore, protection frequently may be given to industries in which the country in question has no hope of securing a comparative advantage; such protection will be needed indefinitely and will result in a perpetual misallocation of productive resources. This form of market intervention is particularly harmful when it is used to force the development of production capacities for products already in excess supply in world markets.

IV. Potential Impact of Performance Requirements on International Trade and Investment Patterns

The total volume and rate of growth in world trade and investment provide fertile ground for the intrusion of trade-related performance requirements on foreign direct investment. Global manufacturing trade and U.S. direct-investment flows have continued to grow dramatically during the recent past, increasing faster than global GNP. (See Tables 4 and 5.) In only four years, from 1973 to 1977, manufacturing exports from developing to developed countries doubled, increasing from $16.1 billion to $33.3 billion. In most product categories it had long been insufficient manufacturing capacity which restricted the growth of manufactured exports from developing countries.[1] Now production capacity in developing countries is increasing more rapidly. Before the 1970s, developing country exports were concentrated primarily in a small number of product groups; since then there has been considerable diversification, and the potential comparative advantages of the advanced developing countries have been extended to activities with a higher input of capital and specialized manpower.

Direct investments from the industrialized countries have played a central role in this development, along with international subcontracting and the geographic reallocation of production within vertically integrated multinational companies. As a result of practically unlimited supplies of semi-skilled labor in many developing countries, the supply of industrial exports from these countries has shown a capacity for very rapid growth once production infrastructures and distribution networks were established.

The effects of trade-distorting performance requirements will almost certainly become more visible as the industrialized countries continue to experience slower rates of growth and the balance of payments difficulties caused by escalating oil prices. In addition, as specialized production capabilities within individual industries continue to expand substantially in the advanced developing countries, the impact of such measures as performance requirements will almost certainly be felt to increase proportionately.

Substantial growth in production in the more advanced developing countries can be expected in several important industrial sectors, as evidenced by a trend toward concentration in these countries in the electronic and automotive industries. The extension to advanced LDCs of the growth of specialization within individual industries also affects the capital-equipment sector (e.g., electrical machinery). As the developing countries master diverse technologies, competition sharpens among the developing countries and between the developed and the more advanced developing countries.

In the petrochemical sector, LDC expansion will probably continue in line with the growth of markets for petrochemical derivatives (e.g., in Mexico, Brazil, Argentina, China, India and Indonesia). It may thus be expected that countries such as these could acquire significant world market shares in such areas as nitrogenous fertilizers, methanol, aromatics, fibers, and common plastics. At the same time, the tendency towards vertical integration will probably continue in those LDC sectors which use domestically produced raw materials (e.g., oil, natural gas, phosphates) with the purpose of both exploiting resources and increasing industrialization. Substantial changes are also likely to occur in resource-based sectors, under a variety of influences: the location of mines, the relative trend of demand in the developed and developing countries, cost levels (of energy in particular), the perceived intensity of environmental constraints, and political risks.

The potential impact of performance requirements in LDCs must be measured against these apparent shifts in the structure of

1 The income elasticity of demand for LDC manufactures in the developed countries has always been high, on the order of three until recently.

Table 4

Growth of Merchandise Exports, by Product Category and Country Group, 1960-76 and 1976-90 (Average annual percentage growth rates, at 1975 prices)

	1960-76			1976-90 (forecast)		
	World	*Industrialized Countries*	*Developing Countries*	*World*	*Industrialized Countries*	*Developing Countries*
Fuels and Energy	6.7	4.5	6.3	3.1	3.3	3.2
Other Primary Products	4 4	5.1	3.7	3.3	3 3	3.3
Food and Beverages	4 4	5.4	3.5	3.7	3 9	3.1
Non-food Agricultural Products	5 1	6.3	3.4	1 8	1.1	2 8
Minerals and Non-ferrous Metals	3.9	3.4	4.7	3.5	3.0	4 5
Manufactures	9.1	9.1	12.7	7.0	6.5	10 9
Machinery and Transport Equipment	9.9	10 0	17.5	7 6	7 1	15.3
Other Manufactures	8.5	8.3	11 8	6 5	6 0	9 0
Total Merchandise	7.4	7 8	6.3	5.7	5.9	6.1

Sources World Bank, *United Nations Yearbook of International Trade Statistics* various issues (New York UN Statistical Office) *Handbook of International Trade and Development Statistics*, various issues (Geneva UNCTAD) and *Networks of World Trade by Areas and Commodity Classes 1955-76* (Geneva GATT, Studies in International Trade No 7 1978)

Table 5

U.S. Direct Investment Flows by Areas (Net):[a] 1966-1976

	All Countries	All Countries (excl tax haven countries) (A)	Developed Countries (B)	Developing Countries	Developing Countries (excl tax haven countries) (C)	International[b] (D)	Tax Haven Countries[c]	Percentage Share of Developed Countries (B A)	Percentage Share of Developing Countries (C A)	Percentage Share of International (D/A)
	(millions of U S dollars)							(%)		
1966	5,416	5,372	4,270	926	882	219	44	79.5	16.4	4.1
1967	4,768	4,743	3,418	1,039	1,014	312	25	72.1	21.4	6.5
1968	5,347	5,233	3,380	1,592	1,478	376	114	64.6	28.2	7.2
1969	6,186	6,192	4,570	1,130	1,136	486	6	73.8	18.3	7.9
1970	7,387	7,303	5,161	1,565	1,481	660	84	70 7	20.3	9 0
1971	7,280	7,197	5,131	1,527	1,444	622	83	71.3	20.1	8.6
1972	7,118	6,956	5,110	1,555	1,393	454	162	73.5	20.0	6.5
1973	11,435	11,194	10,154	630	389	651	241	90.7	3.5	5.8
1974	8,859	6,978	10,811	3,092	4,973	1,139	1,881	154.9	71.3	16 4
1975	14,040	13,362	7,898	6,410	5,732	268	678	59.1	42.9	-2.0
1976	13,032	12,161	10,227	2,828	1,957	23	871	84.1	16.1	-0.2
End 1976[d]	137,244	132,678	101,150	29,050	24,484	7,044	4,566	76 2	18 5	5 3
1966-70	29,104	28,842	20,799	6,252	5,990	2,053	261	72.1	20.8	7.1
1971 76	61,764	57,848	49,329	9,858	5,942	2,575	3,916	85.3	10.3	4.4
1966-76	90,868	86,690	70,128	16,110	11,932	4,628	4,177	80 9	13.8	5.3
1966-70 Average	5,821	5,768	4,160	1,250	1,198	411	52			
1971 76 Average	10,294	9,641	8,222	1,643	990	429	653			
1966-76 Average	8,261	7,881	6,375	1,465	1,085	421	380			
1967-70 Average Annual Growth Rate (%)	8 1	8 0	4.9	14 0	13.8	31 8	17.9			
1971-76 Average Annual Growth Rate (%)	9 9	8.9	12 1	10 4	4.8		47.4			
1967-76 Average Annual Growth Rate (%)	9.2	8 5	9 1	11 8	8.3		34.8			

a Including reinvested earnings and valuation adjustments.
b Including unallocated amounts
c Bahamas and Bermuda
d Direct investment stock, including some valuation adjustments

Source U S Department of Commerce, *Selected Data on U S Direct Investment Abroad, 1966-76.*

the global economy, for in the coming decades the developing countries may emerge as the principal practitioners of the use of performance requirements. Among the industrialized countries of Western Europe and Japan, policies toward inward direct investment may differ in accordance with national policies, but the liberalization of their trade barriers——including free trade among the member-states of the European Communities——has limited the ability of these countries to pursue restrictive investment policies without risking the loss of affected projects to other countries from which traded goods are accepted freely.[1] Trade barriers remain at relatively high levels among the LDCs, however, and so "captive markets" are maintained for their indigenous industries and for any foreign entities permitted to operate within their territories.

1 Certain economic sectors in these countries will continue to be considered "sensitive" with respect to foreign ownership or control, including agriculture, minerals and fuels, financial institutions, defense-related industries and specific high-technology industries. Highly interventionist policies toward inward foreign investment in general in the fully industrialized countries will continue to be concentrated primarily in Canada, Australia and Japan.

2 As noted earlier, this information is not comprehensive, for the data probably reflect only a fraction of the measures actually in effect.

Incidence and Impact of Performance Requirements in Developed and Developing Countries

Table 6 summarizes the data discussed previously on the incidence of performance requirements (see Tables 1-3) in terms of a ranking of the world's leading host countries for direct investment inflows.[2] It is evident that performance requirements of various types are widely used among the principal host countries, developed and developing, other than the United States. More seriously, all of the top 20 host countries other than the U.S. and the U.K. impose the types amounting to "disguised" non-tariff measures——performance requirements which distort trade by restricting imports or expanding exports.

Six of the top 10 recipients of foreign investment are developed countries that impose some form of trade-related performance requirements. (See Table 6.) The United States alone imposes no form of performance requirement. All these countries are major trading nations with an important stake in the stability of the international economic order. The examples set by these nations cannot but give the impression to the rest of the world that performance requirements——no matter how trade-distorting——are acceptable practices in the community of nations.

Table 6
Incidence of Performance Requirements Among Principal Host Countries For Foreign Direct Investment

(Ranked by annual average direct investment inflows, 1972-79)

Rank Country	*Import Limiting*	*Export Expanding*	*Other Performance Requirements*
1. U.S.			
2. W. Germany	●		● ● ● ●
3. U.K.			● ● ● ●
4. France	●		● ● ● ● ● ●
5. Brazil	●	●	● ● ● ● ● ● ●
6. Belgium		●	● ● ● ● ● ●
7. Australia	●		
8. Italy		●	● ● ● ●
9. Netherlands	●		● ● ●
10. Mexico	●	●	● ● ● ● ● ●
11. Singapore	●	●	
12. Canada	●	●	● ● ● ● ●
13. Malaysia	●	●	● ● ● ●
14. Norway	●		●
15. Nigeria	●		● ● ●
16. Spain	●	●	● ●
17. Indonesia	●		● ●
18. Algeria	●		
19. S. Africa	●		
20. Uruguay	●		
21. Austria			● ●
22. Japan			● ●
23. New Zealand		●	●
24. Peru	●		● ● ● ●
25. Ireland			●

Source: Economic Consulting Services Inc.

Nearly half of the leading host countries are developing countries, and four of these——Brazil, Mexico, Singapore, and Malaysia——apply both import-limiting and export-expanding performance requirements simultaneously. Canada and Spain follow the same pattern. The ten LDCs listed in Table 6 registered an average 9.6 percent annual growth in gross domestic investment during the period 1970-78, compared with an average of only 1.8 percent for the developed host countries on the list. The average rate of growth in manufacturing production during the same period was 8.5 percent for the LDC host countries, but only 3.2 percent for the developed host countries. In terms of projected growth rates for merchandise exports (see Table 4), the developing countries as a whole are expected to record substantially higher figures for manufactures through the 1980s than the industrialized countries. Thus, with relatively high growth rates being projected for the domestic investment, manufacturing production and merchandise exports——as well as the greater propensity to employ performance requirements——it is the developing countries which, in the future, are likely to pose increasingly serious problems for the international economy through the use of these measures.

A precise assessment of the impact of performance

requirements obviously warrants intensive analysis; for the purposes of the present study, however, some general orders of magnitude may be identified. The 17 major host countries which impose "import-limiting" performance requirements (see Table 6) accounted for nearly one-half of the U.S. export market in 1979. But, while total U.S. exports increased at an average of 25.8 percent annually over the period 1973-1979, U.S. sales to these 17 countries grew at a slower pace of 22.6 percent annually. The nine major host countries applying "export-expanding" performance requirements accounted for nearly 40 percent of U.S. imports from non-OPEC countries in 1979. Their rates of export expansion varied widely, but from the five non-oil developing countries in the group U.S. imports grew at a rate of 36.9 percent annually between 1973 and 1979——much faster than the average 25.6 percent rate for total U.S. imports from non-OPEC countries during the period.

It may be concluded, then, that the incidence of trade-distorting performance requirements among the world's major host countries for direct investment affects a significant proportion of U.S. foreign trade and is likely to be related to adverse trends in both imports and exports of the United States. The specific adverse economic effects of these measures, as well as the erosion of the rules of the international trading system, must thus be a major issue to be addressed by U.S. international economic policymakers in the years to come.

V. Remedies

There are several available approaches to curbing the use of performance requirements. The two most promising are: first, to utilize remedies under existing international agreements; and second, to negotiate new international agreements and institutions to deal with problems of international investment. U.S. Government policy to date has stressed bilateral negotiations. The results, however, have been disappointing, in part because other governments are unwilling to agree to limitations on practices which they view as important policy tools.

A. Applying Existing International Trade Agreements

Performance requirements can be made the subject of complaints under certain provisions of the General Agreement on Tariffs and Trade (GATT). In addition, the Subsidies Code concluded as part of the Multilateral Trade Negotiations (MTN) would appear to cover export-related performance requirements which are tied to investment incentives. The recent Multilateral Trade Negotiations (MTN) have improved the dispute settlement procedures available under the GATT, so that there is a greater likelihood that a complaint would result in modification of practices which contravene the GATT. Additionally, "friendship, commerce and navigation" treaties prohibit certain types of performance requirements in some countries.

Existing international agreements, therefore, provide an opportunity to proceed against trade-distorting performance requirements. A strong case can be made against them under both the GATT and a number of U.S. bilateral commercial agreements. While each approach will not be effective for all countries (e.g., Mexico is not a GATT member), a successful GATT action would establish the principle that performance requirements which restrict trade cannot be reconciled with accepted rules governing international trade. Establishing this principle——even in a simple test case——would significantly improve the ability of firms making investments, and their governments, to deal with these problems in the future.

1. GATT

Trade-related performance requirements are prohibited by a variety of GATT provisions——those governing: national treatment; elimination of quantitative restrictions; subsidies; and state trading enterprises. Further, in cases where a performance requirement restricts trade in an item covered by a tariff concession, the practice can be considered an impairment of that concession. Performance requirements are being used effectively to restrict trade in a manner inconsistent with explicit GATT obligations and thereby undermine the objectives of the GATT. On this basis, the United States Government and the governments of other investing countries could utilize the procedures of Article XXIII to attempt to bring those countries implementing trade-related performance requirements into compliance with the GATT.

(a) National Treatment (Article III)

The principle of national treatment, like the most-favored-nation (MFN) obligation in Article I, is a rule of nondiscrimination. While the MFN rule prohibits discrimination between products of different foreign countries, national treatment prohibits internal discrimination between imported and domestically produced products.

As a basic rule of nondiscrimination, national treatment is central to the effective operation of the GATT. The basic principle is stated in the broadest possible terms in paragraph 1 of Article III:

"The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production."

The remainder of the Article elaborates this principle to clarify the application of the concept in particular areas, notably as it affects internal taxes and charges, internal laws or requirements, quantitative restrictions, and price controls.

National treatment obligations can be divided into two categories: those relating to taxation and those having to do with other forms of regulation. Performance requirements tied to fiscal investment incentives would fall into the first category. Certain trade-related conditions (e.g., local content requirements) fall into the second category.

Special charges or taxes levied against foreign firms which do not comply with performance requirements regarding local sourcing and value-added appear to be contrary to the first sentence of Article III(2), which forbids "internal taxes or other internal charges (against imported goods) of any kind in excess of those applied, directly or indirectly, to like domestic products." By charging a higher rate of taxation on investments not meeting local sourcing requirements, a country is indirectly placing a charge on imported goods which a manufacturer chooses to use instead of local goods.

Performance requirements resulting in the levying of higher taxes for failure to meet minimum levels of local value-added in production should also be considered prohibited under Article III(1), which states: "...internal quantitative regulations requiring the mixture, processing or use of products in specified proportions, should not be applied to imported or domestic products so as to afford protection to domestic production." Value-added requirements, by definition, involve quantitative regulation of foreign investment operations within the country with the goal of facilitating and protecting domestic production. Therefore, value-added requirements are contrary to the principles stated above.

Paragraphs 4 and 5 of Article III are especially relevant to the issue of local sourcing requirements. They establish rules of equal treatment in the application of domestic laws (paragraph 4) and the prohibition of internal quantitative regulations used for the purpose of protection (paragraph 5).

The drafters of Article III designed these provisions to ensure that imported products enjoy equal competitive opportunity once duties at the border have been paid. The language of the provisions explicitly refers to restrictions or requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions. The purpose of the drafters was to cover every aspect of commercial activity which could be affected by governmental regulations. There is no reason to exclude from the scope of these provisions governmental regulations applied to foreign investors which limit an investor's ability to purchase or offer for sale imported products.

Local sourcing requirements are governmental regulations which restrict commercial purchases by favoring local products over imports according to a quantitative formula. For example, Mexico requires 60 percent local sourcing before a firm qualifies for certain tax exemptions. Such local sourcing requirements,

where applied by a Contracting Party to the GATT, would be inconsistent with Article III(4) and (5).

Special credit terms, grants, and tax benefits specifically tied to the purchase of domestic goods should also be considered prohibited under Article III. For example, Great Britain brought a complaint against the French practice of refunding to purchasers 15 percent of the cost of only domestically produced agricultural machinery. The British also complained about a special fund used by Italy to grant special credit terms on Italian manufactured agricultural machinery.[1] The GATT report recommended that the credit facilities be made available on the purchase of all agricultural machinery, regardless of its origin.[2] A tax reduction or exemption would operate with similar effect as the special credit terms, giving a benefit directly to a firm for the purchase of domestic goods. The result of the practice is a prohibited discrimination against foreign goods.

The GATT draftsmen intended to prohibit local sourcing requirements in Article III. "Mixing (local content) requirements received extensive consideration by the draftsmen. For example, a requirement might be imposed that margarine contain at least 20 percent domestically produced margarine or butter. This would violate the GATT obligation."[3] This principle was upheld most recently in a 1977 case involving a government regulation designed to guarantee the sale of a certain quantity of skimmed milk. A GATT panel concluded that the restriction was inconsistent with paragraphs 1 and 5 of Article III.[4]

GATT panels have consistently upheld the broad application of this provision. In a 1958 case, the United Kingdom challenged an Italian law which granted special credit facilities to purchasers of tractors produced domestically. The GATT panel held that the failure to make the credit facilities available for purchases of imported products was inconsistent with Article III. In reviewing the application of paragraph 4, the panel took special care to point out that the use of the term "affecting" the internal sale, distribution or use was "intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market."[5] The panel went on to clarify that "the intent of the drafters was to provide equal conditions of competition once goods had been cleared through customs."[6]

Finally, it is important to note that Article III applies equally to products subject to a tariff concession bound under the GATT and to those which are not. The logic behind this principle is compelling. Because the GATT is designed to facilitate the reduction of tariff barriers, it follows that the GATT rules are designed to ensure that tariffs, and not performance requirements, are the only legitimate means of providing protection to domestic production. Otherwise, protective trade barriers could escape detection and a contracting party could avoid forever the obligations arising out of any negotiation requiring elimination of such barriers.

(b) General Elimination of Quantitative Restrictions (Article XI)

Value-added requirements should be considered to be in violation of Article XI(1). Article XI(1) prohibits restrictions other than duties, taxes or other charges whether made effective through quotas "or other measures" on the imports of any contracting party. Local sourcing requirements cause firms to purchase goods locally which they would prefer to import. Value-added requirements limit imports of components which a manufacturer would otherwise want to import but is forced to produce locally. The result is a quantitative regulation which is set by a complicated formula. This is more indirect than a simple quota which determines the exact amount of a good which can be imported, but it is effectively the same type of regulation.

At the time the GATT was negotiated, the United States was the principal proponent of a ban on quotas. Among the reasons given by the U.S. for an attack on quotas was the fact that quantitative restrictions "make all international commerce a matter of political negotiation——goods move, not on the basis of quality, service and trade, but on the basis of deals..."[7] Value-added requirements make import levels subject to political deals between firms and host countries rather than "quality, service and trade" factors of the open market.

(c) Subsidies (Article XVI)

Investment incentives or other subsidies which are linked to export performance requirements on nonprimary products should be considered prohibited under paragraph 4 of Article XVI.[8] Investment incentives which are linked to export performance requirements are, in effect, export subsidies. They make receipt of benefits contingent upon the degree to which a firm's output is exported. As such, they function in the same way as export subsidies with the only difference being that standard export subsidies are granted upon criteria other than whether a foreign investor is involved. Those export subsidies banned by Article XVI, which are aimed at foreign investors, should be considered as proscribed under the GATT.

(d) State Trading Enterprises (Article XVII)

The concern of the GATT's draftsmen to curb the use of state controls to influence trade flows is perhaps best illustrated by the General Agreement's state trading provisions. Article XVII is designed to ensure that firms which receive special privileges from the State (which could include investment incentives linked to performance requirements) must be allowed (indeed encouraged) to undertake purchases and sales involving imports or exports in a nondiscriminatory fashion. Furthermore, such purchases and sales are to be made solely in accordance with commercial considerations. Article XVII[9] is designed to proscribe a country from preventing *any enterprise* from operating in accordance with the principles of nondiscrimination and commercial considerations.

When a country causes a firm to import less and/or export more than it otherwise would, it is causing that firm to depart from "the general principles of non-discriminatory treatment" required by paragraph 1(a). It further causes the firm to consider the terms of the performance requirement rather than the "commercial considerations" which must be the sole criteria for purchases and sales under the requirements of the GATT.

1 GATT Doc L/695 (1957)

2 GATT Doc L/833 (1958)

3 J Jackson, *World Trade and the Law of GATT*, 1969 at 289

4 GATT Doc. L/4599 (1977)

5 7 BISD 60 (1958).

6 *Ibid*

7 U.N. Doc. EPCT/A/PV. 22, at 16-17 (1947).

8 Investment incentives or other subsidies which are linked to export performance requirements on primary products would be prohibited where they result in "more than an equitable share of world export trade" for the subsidizing nation. GATT Art. XVI., para. 3.

9 Paragraph 1(c).

(e) Dispute Settlement (Article XXIII)

Under Article XXIII of the GATT, any contracting party can submit a dispute to the GATT for settlement when it feels that any benefit under the GATT has been "nullified or impaired." The concept of nullification or impairment is unique to the GATT and has been the subject of considerable GATT precedent.[1] A *prima facie* case of nullification or impairment arises whenever there is an infringement of the obligations assumed under the General Agreement. This means that there is normally a presumption that a breach of the rules has an adverse impact on other contracting parties, and in such cases, it is up to the other contracting party to rebut the charge. Trade-related performance requirements are in violation of the GATT obligations of host countries which implement them. There is, therefore, a *prima facie* case of nullification or impairment.

Trade-related performance requirements are non-tariff barriers to international trade; they undermine the benefits which a party has a reasonable expectation of receiving when it enters into tariff negotiations and pays for a specific tariff concession. They, therefore, impede the attainment of objectives of the GATT, as well as violate explicit GATT provisions.[2]

Given that trade-related performance requirements appear to violate GATT Articles III, XI, XII, and XVII, there would be a prima facie case of nullification or impairment. Furthermore, trade-related performance requirements impede the attainment of GATT objectives and would, therefore, be actionable. As such, the governments of firms which are subject to performance requirements do have the means to challenge these measures when employed by GATT contracting parties (members).

2. TOKYO ROUND CODE ON SUBSIDIES

Article 9 of the Subsidies Code prohibits "export subsidies on products other than certain primary products." Investment incentives which are tied to export-related performance requirements are, in effect, export subsidies. As such, they are in violation of Article 9.

If performance requirements are imposed in violation of Article 9, consultations may be requested. If a mutually acceptable solution is not reached, the matter may be referred to the Committee of Signatories which can authorize countermeasures.[3]

While developing countries are exempted from Article 9, Article 14(3) states: "Developing country signatories agree that export subsidies on their industrial products shall not be used in a manner which causes serious prejudice to the trade or production of another signatory." While this is the only discipline on developing country export subsidies, namely the requirement that no "serious prejudice" be caused, specific commitments can be made by a developing country in acceding to the Subsidies Code.[4] In negotiating such commitments, reference should be made to the kinds of incentives linked to export requirements which are employed by the signatory country.

3. FRIENDSHIP, COMMERCE AND NAVIGATION TREATIES

A typical FCN (Friendship, Commerce and Navigation) treaty is the one between the United States and Korea. Article XVI(1) places a national treatment and an MFN requirement on products of either party within territories of the other "in all matters affecting internal taxation, sale, distribution, storage and use." Performance requirements governing any of these matters would only be allowed if the same requirements were placed upon domestic firms and applied equally to domestic and imported products. For instance, specific performance requirements relating to export levels are often negotiated at the time of investment approval by the Korean government. These performance requirements are matters which affect sales and distribution. As such, they are arguably in violation of the treaty.

Article XVI(2) requires national treatment in certain matters for goods produced by United States firms in Korea. Export requirements not placed upon domestic producers would violate this article since national treatment is required "in all matters affecting *exportation*, taxation, sale, distribution, storage and use" (emphasis added).

B. New International Agreements as a Means of Curtailing the Use of Performance Requirements

1. RECENT DEVELOPMENTS

Some progress has been made toward drawing the attention of the international community to performance requirements and the need to regulate their use.

(a) As a result of their review last year of the 1976 Investment Declaration, the member countries of the OECD have embarked on a Medium Term Work Program on investment incentives and disincentives. The first stage of this program will consist of an analysis of the effects of such measures on the international investment process. The second will deal with their impact on international economic relations. This effort may result in agreement on more effective ways to deal with problems in this area among the OECD countries, which are both homes and hosts to most of the world's international investment.

(b) An Investment Task Force (previously chaired by the then Assistant Treasury Secretary C. Fred Bergsten) was created under the auspices of the Development Committee, an intergovernmental group under the combined auspices of the International Monetary Fund and the World Bank. This task force of representatives from both industrialized and developing nations is searching for specific steps which might be taken to improve the contribution of direct investment to the development process. This includes the possibility of new international arrangements to limit the use of incentives and performance requirements.

(c) The United States has been engaged in bilateral talks with Canada over the use of investment incentives in the

1 The dispute settlement provisions of the GATT have recently been revised in the Framework Agreement. This agreement has codified a number of features of the GATT dispute settlement mechanism which have become important parts of GATT practice.

2 Appendices B and C provide detailed accounts of trade-related performance requirements in Mexico and Canada, and their discriminatory and distorting effects which impede GATT objectives. Mexican performance requirements are sufficiently publicized and noteworthy that they are used as examples throughout this paper although Mexico, not being a GATT member at this time, would, therefore, not be subject to the GATT's dispute settlement procedures.

3 See Part VI of the Subsidies Code for the procedures involved.

4 The United States Government has adopted a policy of requiring that developing countries make commitments to phase out or eliminate subsidies as a condition to receiving the injury test under the U.S. countervailing duty law. It is critical that this policy be maintained and implemented.

automobile industry. These discussions stem originally from U.S. Government protests over the Canadian grant to Ford in August 1978, but relate more broadly to the traditionally close cooperation between these two countries in the automotive sector. These talks may ultimately result in agreement between the United States and Canada to limit such incentives.

(d) The British Minister of Industry, Mr. Keith Joseph, has publicly indicated the British Government's interest in achieving an agreement regulating the use of incentives to bid for internationally mobile investments.

(e) Brazil has recently decided to eliminate immediately its major export subsidies and to participate in the new subsidy code. This exemplifies an improved willingness on the part of a key developing country to consider the international impact of domestic measures and to eliminate artificial practices which could harm foreign industries as Brazilian industries become internationally competitive.

2. BILATERAL AGREEMENTS WITH DEVELOPING COUNTRIES

Bilateral agreements on investment may offer a way to address the problem of performance requirements within the larger context of the investment area. Efforts to succeed in bilateral negotiations may be hampered by traditional concerns over seeking reciprocity, as well as the political volatility of the direct foreign investment issues in developing countries. Performance requirements are too often viewed as a means of controlling investment, and the economic costs are not always immediately apparent. Therefore, there may be substantial reluctance to regulate the use of these measures through bilateral agreements.

3. A MULTILATERAL AGREEMENT GOVERNING INVESTMENT

It has been suggested that a "GATT for investment" or a "GATT for multinationals" be established to deal with a variety of issues including performance requirements. This approach has not been feasible due to a variety of political factors. However, it may conceivably become a realistic possibility in the long run.

VI. Conclusion

Many commonly used performance requirements directly or indirectly impair the value of international trade agreements and greatly distort international flows of capital investment with serious consequences for exports, imports, production and jobs. The problem appears to be growing larger each year. The examples cited in this paper indicate how widespread performance requirements have already become.

Performance requirements threaten to undermine the system of agreements and institutions which govern international trade, principally the General Agreement on Tariffs and Trade (GATT). The latest and most ambitious round of multilateral trade negotiations within the GATT framework, the "Tokyo Round" concluded in 1979, was distinguished by the development of several international codes covering non-tariff trade barriers. Now foreign direct investment performance requirements are appearing as the most serious non-tariff distortion to international trade. There is every reason for those interested in maintaining an open world trading system, free of distortions to the maximum extent possible, to move vigorously against the use of performance requirements.

A motivating factor of equal weight is the fact that this new outbreak of unfair trading practices threatens to erode the manufacturing base that underlies the strength of the American economy.

To begin to combat these practices, the improved dispute settlement procedures of the GATT should be utilized to obtain a determination of the inconsistency of performance requirements with the GATT. In addition, the bilateral and multilateral approaches outlined above should be pursued in bodies such as the OECD and the IMF/World Bank Development Committee, and eventually in the GATT.

Additional information and analysis on the nature, incidence, effect, and legal status of performance requirements is essential. This paper of necessity represents only a limited first step. Information on the policies of foreign nations and the experiences of U.S. corporations is still very limited. In view of the increasing importance of trade-related performance requirements, uncoordinated private efforts must now give way to a major study, completed by, or with the full cooperation of, the U.S. Government, and by concerned international organizations. To date, insufficient resources have been dedicated to this problem.

This paper should be seen as an attempt to spur interest and activity. It is a first word, not a final assessment. We look forward to cooperating in further efforts to assess and establish firm U.S. policy and initiatives to limit the use of trade-distorting performance requirements.

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APPENDIX A

Examples of Performance Requirements

In spite of the covert nature of many performance requirements, their prevalence is apparent. The following are offered merely as examples:

(1) ARGENTINA:

(a) The automobile and tractor industries are required to increase local content.

(b) Foreign investments receiving incentives require previous approval by the Chief Executive. Investment proposals requesting incentives are judged on a case-by-case basis. Approval depends upon whether the investor will (among other things) expand exports, substitute for imports, and process regional raw materials. New laws and regulations provide penalties for non-compliance with the obligations agreed upon when incentives are granted. A company's failure to uphold an incentives agreement will meet with the following penalties depending on the gravity and magnitude of the offense: total or partial forfeiture of financial incentives; fines from 1-10 percent of the amount of the project; and payment of all or part of the taxes and duties not paid by reason of the incentives plus interest.

(2) AUSTRALIA

(a) Automobile manufacturers are allowed to import automotive parts up to the dollar value equivalent of the components exported by the manufacturer. Under the current plan 85 percent local content in the automotive industry will be required by 1985.

(b) Authorities use the firm with the highest percentage of local content as a standard for others in the same industry. Firms which do not live up to this standard are threatened with revocation of tariff concessions for essential components.

(3) BRAZIL

(a) To qualify for special financing for mining and mineral processing, a company must, among other things, export at least half of its output and, when processing is involved, guarantee at least 50 percent value-added.

(b) The government levies an ad valorem industrial products tax at each production stage (IPI taxes). The Industrial Development Council (CDI) may reduce the IPI by 80 percent in the higher priority industries and 50 percent in the lower priority ones on Brazilian-made equipment or on imported equipment when Brazilian-made equivalents are not available. Up to 15 percent of the total f.o.b. value of export shipments may be credited against IPI taxes due on the manufacturer's domestic sales.

(c) Profits from exports of virtually all manufactured products are exempt from income taxes. New investment exporting minerals that Brazil has in abundance, such as iron ore and manganese, are exempt from taxation on their export income.

(d) Firms with export programs approved by the Export Fiscal Incentive Commission (BEFIEX) can amortize start-up costs over ten years and apply as a credit against income taxes any payments of the 40-60 percent Brazilian withholding tax in excess profit remittances (those above 12 percent) that are attributable to export earnings. Under the BEFIEX program, the investor negotiates an agreement involving a commitment to export a specified volume of goods within a fixed period in return for the right to import equipment needed for the project.

(e) Exporters may deduct from taxable income payments made abroad in connection with export sales (e.g., advertising, participation in fairs).

(f) Accelerated depreciation is available on a case-by-case basis for locally made equipment.

(g) For firms with a relatively low volume of exports, there is a system whereby the government grants up to a 90 percent reduction in import duties (and the IPI tax) on imported equipment used in production for export, as well as an exemption from the 360-day prior deposit requirement for imports.

(h) In granting reductions in the IPI and ICM (Merchandise Circulation) taxes, CDI generally requires a high percentage of local sourcing. A project must also have a favorable balance of trade in order to qualify for ad valorem tax reductions.

(i) Value-added requirements have been imposed, beginning with the auto industry, which was granted incentives in return for achieving a progressively increasing percentage of domestically made parts. Other incentive programs are also tied to value-added on a less stringent basis. Nevertheless, a number of foreign companies that have long exported to Brazil are now establishing production facilities within Brazil. This new trend is a result of the Brazilian import licensing program where delays and rejections are common and the expense of the prior import deposit scheme requiring 100 percent deposit of the value of the import for 360 days.

(j) There are several additional policies to promote import substitution. One is the "law of similars" whereby projects approved for fiscal incentives must use nationally produced equipment whenever it is available——even if it is more expensive, slower in delivery, or otherwise uncompetitive with an import. Another device is the "participation agreement" in which a national content percentage is negotiated with CACEX, the national import licensing office, for a given industrial project. This agreement spares capital goods buyers from seeking item-by-item approval of import licenses but also results in a higher local content than otherwise might have occurred.

(4) CANADA

(a) The Canadian Automobile Agreement: This Agreement eliminated tariffs on trade in specified automotive products

between the United States and Canada. However, only "bona fide" Canadian vehicle manufacturers may import these products duty-free to Canada. In order to be considered "bona fide," manufacturers must meet certain minimum Canadian value-added and Canadian production-to-sales ratio requirements.

(b) The Foreign Investment Review Act requires that all foreign investments be approved by the Canadian government. The statute lists the criteria to be applied. These include "the effect . . . on utilization of Canadian parts, components, and services, and on exports."

(5) FRANCE
All foreign investments must be approved by the government. The Economics Ministry has broad discretion in reviewing applications from potential investors. However, the following are generally considered in the decision: impact on the balance of payments, number of jobs created, location, and general benefit to the economy.

(6) GREECE
(a) In some cases foreign investments have received government approval on the condition that a specified percentage of production be exported.

(b) In order to receive government approval, foreign investments must meet a variety of requirements regarding repatriation of capital and profits.

(7) INDIA
(a) Firms that export at least 25 percent of their output are given more liberal treatment in import licensing and have more freedom in choosing import sources.

(b) Large firms that export at least 25 percent of production get one-third of their requirements in free foreign exchange up to one million rupees. Qualifying smaller firms get all of their requirements in free foreign exchange.

(8) INDONESIA
(a) All foreign investment projects must receive government approval. Industries which process local raw materials are highly favored in the approval process.
(b) Tax benefits are agreed upon in negotiations for investment approval. The government publishes a list of considerations for deciding which investment proposals should be given priority for approval and/or tax benefits. Among the six top priority considerations are industries using more domestic than foreign materials, and ventures that are export oriented.

(9) KENYA
The government encourages local sourcing among foreign investors. This is done by eliminating domestic credit for import financing, and through an import-deposit scheme which discriminates in favor of industries using local raw materials.

(10) KOREA
(a) Duties and taxes on raw material imports are refunded if they are used in exported products.
(b) New foreign investment projects and expansions must be approved by the government. Performance requirements are often prerequisites for approval. The most common requirement is one calling for a specified percentage of production to be exported.

(11) MEXICO
(a) To qualify for tax exemptions, companies generally have to meet certain requirements including that goods produced must be 60 percent locally sourced.
(b) Some companies are allowed to exclude 50-100 percent of their export income from their corporate income taxes for several years.
(c) Exporters of certain manufactured products are eligible to receive rebates of up to 80 percent of the indirect taxes (e.g. gross receipts or sales tax) paid by the exporting company.
(d) Discounts of up to 75 percent of import duties are also granted importers of machinery if the machinery is used for export production.
(e) Mexico has a number of financial trusts that make credit available at less than market rates for such uses as the purchase of capital goods. Projects are judged on several criteria, including the amount of foreign exchange generated and the value-added
(f) The Mexican automotive decree places numerous performance requirements on foreign investments in that sector. It is discussed in Appendix B.

(12) YUGOSLAVIA
(a) Transfer of profits and liquidation of proceeds are limited by law. However, these limits are made quite generous for exporting enterprises. Additionally, the government requires that ventures involving foreign investment contribute directly or indirectly to exports.
(b) Importation of goods is carefully regulated and local sourcing is favored. Foreign goods may be imported upon three conditions: (i) after open bidding, (ii) after carrying out a tender and receiving bids from a specified number of bidders, and (iii) by direct negotiation. Where domestic suppliers offer more favorable terms, priority is given to the foreign supplier who employs domestic suppliers to the greatest extent or extends the most credit to the domestic manufacturer.

Research Note The best available sources for information on performance requirements abroad are

"A Comparative Study of Export Incentives in the United States, France, the United Kingdom, Germany, and Japan" (International Division, Chamber of Commerce of the United States, 1979),

"Investment Incentive Programs in Western Europe" (International Division, Chamber of Commerce of the United States, 1978),

"Incentives and Performance Requirements for Foreign Direct Investments in Selected Countries" (Industry and Trade Administration, U.S. Department of Commerce, January, 1978),

"Investment, Licensing and Trading Conditions Abroad" (Business International, updated regularly)

APPENDIX B

The Mexican Auto Decree

The Mexican Decree for Development of the Automotive Industry offers an excellent case study of performance requirements and their trade-distorting effects. It was promulgated in 1977 and is scheduled to take full effect by 1982. The Mexican automotive decree has two objectives. These objectives are: (1) accelerated growth of the domestic automotive industry; and (2) generation of foreign exchange. Similar measures are reportedly under consideration for textiles, steel, petrochemicals and other sectors. The experience with the automotive decree is expected to weigh heavily in these future decisions

The auto decree discriminates against foreign-owned firms and products through a number of complex regulations, which include the following:

> 1. Foreign exchange allowances favor "national" firms over "foreign" firms according to the degree of Mexican equity participation.
>
> 2. By 1982, motor vehicle assemblers must cover 100 percent of all foreign exchange costs through their own net exports. "Net exports" is defined in the decree (Article 5) as "Products sales value, less imported content" of all vehicles, jigs and automotive components exported. The decree also stipulates that automotive manufacturers are required to generate 50 percent of their net foreign exchange requirements through exports of any parts and/or components manufactured by companies of the parts industry having a manufacturing program approved by the Mexican Government. The remaining 50 percent can be obtained by means of export of vehicles and parts and components manufactured by their own plants or by companies not so approved.
>
> 3. The decree will gradually increase the percentage of local content required in production of vehicles, specified by model, for both Mexican and foreign-owned firms.

The trade effects of the decree will include:

- Reduced sales of U.S. auto parts in Mexico;
- Reduced U.S. sales of vehicles to Mexican free zone areas; and
- Increased sales of Mexican automobiles and parts to the U.S.

The U.S. automotive industry has estimated that, if the decree is implemented as planned, exports of Mexican auto parts to the U.S. will rise to over $2 billion by 1985 (from $89 million in 1976, the year before the decree was promulgated). $2 billion of U.S. imports translates into loss of approximately 86,000 jobs in the automotive and related supply industries. Mexican exports to the U.S. will also be increased to the extent that U.S. automobile manufacturers choose to export instead of utilizing a greater degree of local content. This will result in increased production in U.S. plants in Mexico with subsequent importation of the products back to the U.S. market.

The first example of a U.S. automobile manufacturer making such a choice has occurred this year. Chrysler de Mexico (99.4 percent owned by Chrysler U.S.) has decided to build an engine plant with an annual production of 200,000 four-cylinder engines in Mexico. Three-fourths of the annual production——150,000 engines valued at approximately $60 million——is to be exported to the U.S. every year. Presently, Chrysler U.S. imports its four-cylinder engines from Germany. However, economic considerations (including a growing U.S. market and favorable exchange rate changes) encouraged Chrysler to shift its four-cylinder engine production. Given that the engine will primarily be used in the U.S. market and that engines produced in Mexico are no cheaper than those produced in the U.S., Chrysler would probably have located the new engine plant in the U.S. had it not been for the Mexican automotive decree.

Chrysler de Mexico (Chrysmex) currently runs a $200 million trade deficit with the U.S., consisting mainly of auto parts. This is only partially offset by whole car exports to third countries. Under the terms of the automotive decree, Chrysmex will have to balance its trade by 1982 or face a government-imposed cutback in its production. Accordingly, in order to maintain present production levels, Chrysmex must either decrease imports or increase exports. Chrysler chose to produce four-cylinder engines in Mexico to supply both its Mexican and U.S. needs because management believed that it could not decrease imports to Mexico and still produce a competitively priced car there.

The important point in this case is that the performance requirements stated in the Mexican auto decree forced Chrysler to make one of two choices, both of which would have adverse effects on the U.S. If Chrysler did not build the engine plant in Mexico, it would have been forced to reduce imports of auto parts from the U.S. On the other hand, the decision to locate in Mexico instead of the U.S. means the loss of jobs and production capacity, and negative balance of payments effects in the U.S.

APPENDIX C

The Canadian Foreign Investment Review Act

Canada's Foreign Investment Review Act offers a revealing example of how performance requirements operate in a developed country. The Act requires that a notice of every proposed or actual investment to which the Act applies be submitted to the Foreign Investment Review Agency. The Agency staff reviews the application, and advises the Minister on the proposal. The Minister's recommendation is then submitted to the Governor in Council, who makes the final decision. The investment is allowed only if it is likely to be of "significant benefit" to Canada.

The criteria, according to which "significant benefit" is determined, are enumerated in the Act. They include "the effect...on utilization of Canadian parts, components and services, and on exports." Thirty-seven percent of all acquisition proposals and thirty-two percent of all new business proposals which were allowed provided some form of export-related benefit. Furthermore, fifty-six percent of all acquisition proposals and sixty-five percent of all new business proposals which were approved provided for benefits in the form of resource processing and procurement in Canada. Therefore, many of the foreign investments which are approved in Canada are committed to meet trade-related performance requirements.

The vast majority of applications for investment under the Act have come from American investors. During the five years since the Act has gone into effect, 61.5 percent of the reviewable applications were from the United States, 31.7 percent from Western Europe and 6.8 percent from the rest of the world.

Foreign investors are held to the terms of their proposals through established procedures for the monitoring and enforcement of performance requirements. From 1977-78 to 1978-79, the number of cases monitored for compliance almost doubled to 851 from 442. Sanctions may be imposed where an investor fails to comply with the terms and conditions of his investment, as set forth in his application or his plans and undertakings. The Act authorizes the Minister to prosecute companies in court or even rescind approvals of investments in extreme cases.

Canadian performance requirements may take various forms. In the Minister's Annual Report he states that "some investors have established a specific export target, expressed as a percentage of output or sales, and have undertaken to reach the target within a given time period. Other investors have undertaken to assign to the Canadian business exclusive rights to export either all its products to certain countries or certain specified products on a worldwide basis."

Some investment proposals have included commitments for the further processing of (Canadian) mineral ores. Other investors who found it uneconomical to build their own processing plants have undertaken to have their raw materials processed by Canadian processors provided that the terms offered by these processors are internationally competitive. With respect to local sourcing, the Minister states in his annual report: "Experience has shown that most investors are willing to undertake to source in Canada, but often with the proviso that Canadian sources are competitive in terms of price, quality and availability. This has come to be a more or less 'standard' undertaking which is commonly offered or negotiated."

The wide use of trade-related performance requirements in Canada is apparent from the annual report. The Canadians have thus succeeded in forcing foreign investors to conform with their national trade policy without regard for the interests of other states or the efficient international allocation of production.

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"Trade-distorting performance requirements result in a direct transfer of investment, jobs and production to the country which imposes them--away from other countries. The international shifts in investment, employment, production and trade which they cause are not a response to market forces. Rather, they are the result of government fiat. Their purpose is to increase the economic welfare of the country imposing such measures directly at the expense of other countries--a new form of beggar-thy-neighbor policy."

"The United States should not hesitate to pursue the remedies available under international agreements to challenge these unfair, discriminatory practices. If we fail to act, we may, through silence, legitimize these practices, and thus contribute to their proliferation."

LICIT

1660 L Street, N.W. / Suite 1100 / Washington, D.C. 20036 (202) 452-7452

The CHAIRMAN. Also, I would submit a statement from Joseph E. Connor, chairman of Price Waterhouse & Co., concerning U.S. policy on international investment.

Without objection, that will be placed into the record.

[The information referred to follows:]

PREPARED STATEMENT OF JOSEPH E. CONNOR

U.S. POLICY ON INTERNATIONAL INVESTMENT—WHAT IS IT? WHAT SHOULD IT BE?

In the United States today there appears to be a new awareness of the need to participate more realistically and meaningfully in the international economy. We are no longer living in a world where reliance on our domestic markets and our own economic resources is sufficient to maintain our important economic position.

As a result, considerable attention is now being given to finding ways to improve our country's international economic competitiveness. Part of that attention has correctly focused inward. The Administration's position is that the United States cannot compete effectively on a worldwide basis unless our domestic economy is strengthened, and its proposed program of tax and budget cuts is designed to help meet this objective. Other attention has been directed outward to our trade and investment relationships with other countries. Typically when considering these relationships, we have been largely peroccupied with trade issues and have devoted far less attention to our international investment position.

We agree that trade issues are important, but international investment policies must receive increased attention. We should not wait for a crisis.

We believe the United States Government should not retreat from its long-standing policy of neutrality toward inward investments for what at best may well be short-term benefits. But, it must be more aggressive in seeking the elimination of restrictive investment and trade policies and practices of other governments. We should build bridges rather than walls.

To elaborate on our position, the remainder of this statement will discuss the following points:

U.S. direct investment overseas can benefit the U.S. economy by helping to increase our exports and by reducing the need for foreign aid.

The U.S. Government policy of neutrality towards foreign investment and pursuit of national treatment, as articulated in 1977, is a sound one. But, failure to implement it fully has placed U.S. business at a disadvantage in dealing with restrictive investment practices by host country governments.

The private sector needs more support from the U.S. Government in overcoming tax and nontax barriers and restrictions to foreign investment in other countries. This support should take the form of a sustained, aggressive program to achieve national treatment of U.S. investment by host governments.

National treatment can best be achieved through negotiation of equitable bilateral tax and investment treaties with host governments.

In working to promote the free flow of U.S. investment abroad, certain U.S. Government policies which impede such investment must also be addressed.

The benefits of U.S. direct investment abroad

In seeking to improve the international competitive position of the United States, the positive benefits of U.S. investment abroad cannot be overlooked, including increased exports and some reduction of foreign aid.

Trade and investment flows are closely related. Studies have shown that increased investment abroad should result in increased exports. This should be especially true in the developing countries. U.S. investment in such countries can strengthen their domestic economies by bringing in new capital, generating local tax revenue, and providing jobs, infrastructure, new technology, and a market for local resources and raw materials. Thus, the ability of host country governments, businesses and individuals to purchase capital and consumer goods and services from the United States is enhanced.

Furthermore, in the case of both developed and developing countries, the establishment of local subsidiaries is an effective way of overcoming trade barriers which the exact same merchandise might encounter if produced and exported by a domestic U.S. company. In other words, foreign direct investment makes possible the penetration of export markets which might otherwise be closed to

U.S. businesses. Our major trading partners realized this fact some time ago. That is one reason why foreign companies are now establishing subsidiaries in this country to manufacture goods for sale in our domestic markets.

In cooperation with the U.S. Council of State Chambers of Commerce, Price Waterhouse recently completed a study entitled U.S. Investment Abroad. The study shows that such investment is indeed beneficial to our economy, and that it has not contributed significantly to the economic ills often attributed to it. For example, there was no evidence of significant loss of domestic markets by U.S. based companies due to competition from U.S. affiliates abroad, or of loss to U.S. foreign affiliates of export markets which could have been supplied by U.S. based companies.

Briefly, our study suggests four ways in which establishment of foreign affiliates by U.S. companies may impact U.S. trade:

1. The domestic supply linkage.—Estimates are that a major portion of the initial fixed investment of U.S. manufacturing affiliates abroad is spent to import U.S. equipment, materials and services. These initial imports lead to long-term and secure export markets for replacement and spare parts.

2. Sales to local market.—Official data and survey evidence indicate that 75–80 percent of sales of foreign affiliates are to the local market. Opponents of foreign investment claim that these exports are in large part displacing exports from domestic U.S. companies and therefore robbing U.S. citizens of jobs. The study, however, contends that the markets being supplied by U.S. foreign affiliates could not have been served effectively from a U.S. export base. The markets would instead have probably been lost to foreign competition.

3. Stimulation of exports through foreign affiliates.—The fact that a company has a foreign "presence" with established sales and service networks raises sales of product lines from the United States which are not produced in the foreign affiliates.

4. Sales from U.S. foreign affiliates to the U.S. market.—Potential competition with U.S. products from goods produced by foreign affiliates is a possible negative impact of foreign investment. However, evidence indicates that the magnitude of the problem is relatively small. (Further data concerning this factor is presented below.)

The study, due to be released in published form next month, discusses each of the above factors in greater detail. A prepublication draft is included as an attachment to this statement.

Other studies have also been performed which support the thesis that U.S. investment abroad benefits our domestic economy. One of the best-known is the research series developed by Business International, Inc. (BI) entitled "The Effects of U.S. Corporate Foreign Investment." This series, initiated in 1970, was undertaken specifically to test the so-called job-export theory, i.e., U.S. investment overseas results in unemployment at home. It is based on the results from questionnaires submitted to a sample of U.S. manufacturing and petroleum companies, including some of the largest and most prominent corporations in the United States.

The latest volume in the BI series covers 1979 and includes summary data for the period 1970–1979. Some of the key findings, as quoted from the study, are as follows:

Exports.—The sample's exports increased more rapidly in 1979 than total U.S. manufacturers' exports (18.2 percent vs. 8.8 percent). Firms in the sample with higher percentages of foreign investment increased their U.S. exports faster than did those with lower levels of foreign investment.

Employment.—Highly foreign-investment-oriented U.S. companies increase U.S. employment faster than other U.S. manufacturing firms. Overall U.S. employment in manufacturing rose 4.4 percent during the 1970–79 period. For the companies in the sample, total U.S. employment rose by 27.8 percent and net employment rose by 14.2 percent. Over the 1970–79 period, the firms in the sample investing the most outside the United States increased their U.S. net employment by 21.3 percent, while those investing lesser amounts outside the United States increased U.S. employment by 7.5 percent.

Import competition.—Imports by the manufacturing companies in the sample from their foreign affiliates as a percentage of sales to U.S. customers were a mere 1.1 percent in 1970 and 2 percent in 1979. The proportion of imports of finished goods by manufacturing companies from their foreign affiliates to total imports fell during the 1970–79 period.

Balance of payments.—Total remittances to the United States (of dividends, branch earnings, interest, royalties and fees) for the sample rose from $1.4 billion in 1970 to $4.5 billion in 1978 and $7.4 billion in 1979.

The gross balance-of-payments surplus of the sample reached $17 billion in 1979, while the overall U.S. payments position was in heavy deficit.

The above data suggests that U.S. investment overseas is beneficial to the economy and does not lead to net domestic unemployment.

Interestingly enough, to our knowledge no recent study has been performed which directly correlates U.S. export and investment flows on a country-by-country basis over a number of years. We believe such a study might prove useful in making a strong case for increased U.S. investment abroad.

Finally, in the less developed countries, U.S. investments can help accelerate the modernization and growth processes and thereby lessen to some extent the requirement for official international assistance. For example, the U.S. Agency for International Development program in Egypt has been providing approximately $850 million of economic and technical assistance annually in recent years. An important portion of such assistance is directed toward promoting the industrialization process through improving productivity, developing opportunities for foreign private investment and expanding the private sector role in the Egyptian economy. To the extent there is an increase in U.S. foreign investment in Egypt, there should be an increase in demand for U.S. exports and a lessened need for such massive amounts of foreign assistance.

Impact on the private sector of failure to implement U.S. investment policy

Contrary to the claims of some, the U.S. government does have a stated policy on foreign investment, but it has not been fully implemented. Little progress has been made in achieving the policy's fundamental objective of preserving the free international flow of capital. Barriers to inward foreign investment continue to exist in many countries and, regrettably, new ones are being instituted by some countries. These barriers may take the form of laws and requirements which apply to all business, both domestic and foreign, but which in practice are particularly burdensome for foreign-owned companies; or they may take the form of direct restrictions and requirements which apply only to foreign investment.

The current U.S. Government position on international direct investment was set forth in a July 6, 1977, policy directive released through the State Department. This document stated that:

The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward investment flows or activities. This policy is consistent with and reaffirms our longstanding commitment to a generally open international economic system.

The directive went on to affirm that "the United States has an important interest in seeking to assure that established investors receive equitable and non-discriminatory treatment from host governments."

Accordingly, one objective of the United States government should be to "obtain equitable treatment for investors consistent with such principles as national treatment of established firms and compliance with international law."

Price Waterhouse fully endorses the commitment to an open international economic system, and we strongly believe that the United States should work to ensure that every country pursues the objective of "national treatment" toward foreign investment. Governments should not treat foreign-owned companies any more or less favorably than they treat domestically-owned companies. Moreover, we believe a positive program to facilitate U.S. direct investments abroad should be developed.

We realize that certain interests are protesting what they consider to be "the selling of America" to foreign investors and are calling for restrictions. Of course, there may be selected circumstances where some limited restrictions may be necessary for national security or other significant reasons. However, we can hardly expect equitable treatment of U.S. investors overseas if we unduly restrict the opportunity of foreign businesses to participate in our economy. Moreover, the magnitude of foreign ownership of U.S. enterprise must not be blown out of proportion. While foreign investment in the United States has grown dramatically,

in the overall context of the American economy the foreign presence is relatively small. More importantly, total American direct investment abroad is almost four times as large as its counterpart in the United States.

What's needed now is heightened pursuit of overseas investment by U.S. business. We must be tough business competitors, and our government officials must be firm in ensuring national treatment by host governments.

Unfortunately, in the past, our policy of neutrality has too often been interpreted as a "hands-off" position. U.S. companies seeking to invest abroad may receive no hindrance from U.S. Government officials here or in the host country, but neither do they always receive active assistance in obtaining equitable treatment. Furthermore, overall, there has been no clear U.S. strategy or sustained, aggressive effort to obtain national treatment in host countries.

This "arms-length" stance of our government places U.S. companies in a weak negotiating position in trying to overcome discriminatory treatment, especially in countries where the government and the local private sector are working in a close harmony to promote and direct economic development. Thus, so-called neutrality in practice often generates inequities, in direct contradiction to the objectives set forth in the 1977 directive.

New support for private sector investment efforts: Pursuit of national treatment through bilateral negotiation

If the United States Government is committed to a policy of economic revitalization and accepts that direct investment overseas by American companies is one way of achieving this objective, then it is time for the government to be more supportive of private sector efforts to overcome discrimination against inward foreign investment in countries where it exists.

This does not mean that the U.S. Government should become a partner in promoting U.S. investors' interests. It also does not mean greater government control of business. It means, quite simply, the reaffirmation and implementation of all aspects of the 1977 directive. Specifically, the U.S. Government should work actively, in cooperation and consultation with the private sector, to achieve national treatment of U.S. investment by host governments. We need do no more than this, because by doing so we will be in a better position to overcome barriers to the free flow of investment which currently impede U.S. companies' ability to operate or expand overseas.

We endorse U.S. participation in multilateral efforts to overcome barriers to the free flow of international investment, such as the activities of the Organization of Economic Cooperation and Development (OECD). We feel, however, that the most effective way to achieve national treatment of U.S. investment abroad is through bilateral negotiation with host governments in countries where U.S. business already has a strong investment position, as well as in countries where increased U.S. investment would be desirable. In pursuing such negotiations, the experiences of U.S. businesses which have encountered discriminatory practices firsthand would be invaluable.

Tax treaties

One of the most powerful instruments of bilateral negotiation is the tax treaty. The United States currently has tax treaties with forty-nine countries (see Exhibit at end of statement). But, many of these treaties do not address all significant tax barriers to direct U.S. investment, and we have not negotiated tax treaties with most developing nations, the more advanced of which are promising locations for investment. While significant progress has been made, the U.S. Government must work even more aggressively to achieve national treatment of American investment through negotiation of bilateral tax treaties. Following are some of the significant issues which such negotiations might address.

Imputation system.—The usage in many developed countries of the imputation system for taxation of companies and their shareholders has been identified as a major tax exception to national treatment. Under such a system domestic shareholders can offset against their own income tax liabilities all or a part of company income tax attributable to dividends received, or they can claim a refund on that basis. The same benefit, however, is not available to foreign shareholders, resulting in the payment of higher taxes to the host government.

Consequently, U.S. investors, for example, may be reluctant to invest in countries where the system is in effect. Such countries, however, include Belgium, Denmark, Canada, Germany, England, France, Italy and Japan, so U.S. investors have the difficult choice of either avoiding a number of promising investment sites or simply paying the higher taxes.

Of all countries with imputation systems, only the United Kingdom has taken significant steps to extend a comparable benefit to foreign shareholders. This has been done through a modification of the tax treaties to which the United Kingdom is a party, including a treaty with the United States. A few other countries provide some relief for foreign portfolio investors, but they do not extend the benefits to foreign direct investment. The United States should vigorously pursue this matter in treaty negotiations and be prepared to offer reasonable concessions in return. Perhaps compromise on the state unitary tax issue should be considered to the extent allowable under the U.S. Constitution. Outside of the treaty network, we are in favor of overall legislation to restrict the unitary method of state taxation.

Royalties and Head Office Expense.—Developing countries have frequently formulated their tax codes from vastly differing economic, social and industrial perspectives than those found in developed countries. Partially for this reason, they have tended to formulate tax policies which discriminate against foreign-owned companies.

A good example of this is in the royalty area. Many developing countires, including Brazil, Chile, Colombia, Ecuador and the Philippines tax royalty payments to foreigners on a gross basis without allowance for expenses incurred in earning the royalty income. In addition, some countries (notably Brazil) do not allow the payor a deduction for the royalty payment, in effect treating the payment as a dividend. Another area of discrimination is the disallowance of expenses incurred overseas on behalf of a subsidiary in the developing country or the disallowance of the subsidiary's share of head office expenses. This practice is found in Colombia, Mexico and the Dominican Republic, among others.

These royalty and head office expense policies are often established because the developing countries are concerned over the outflow of local currency and the exchange problems it could create, rather than because they are attempting to actually discourage foreign investment.

Tax sparing credits.—It appears that a major impasse in establishing a treaty network with developing countries is the issue of tax sparing credits. In an effort to encourage foreign companies to establish local manufacturing facilities, many developing countries will offer tax holidays and other tax credits to foreign entities. However, such credits are useful only if the company achieves an overall tax savings. To the extent the savings are offset by an increase in the home country tax (i.e., a corresponding reduction in the foreign tax credit available to U.S. companies), the incentive for investment is lessened. Some developing countries take the position in treaty negotiations that the developed country should allow a "tax sparing credit" with respect to the tax holidays and incentive credits. This means that the developed country would allow a foreign tax credit in an amount which would have been allowed had the company not been given a tax holiday or incentive credits in the developing country.

While we do not feel that such "tax sparing credits" are in accordance with national treatment, we believe that consideration should be given to compromise on this issue, providing a tax treaty can thereby be negotiated which achieves an overall movement towards national treatment (e.g., if the developing country will compromise the royalty and/or head office expense issues). Several other developed countries have allowed "tax sparing credits" in their treaties with developing countries.

Investment treaties

Tax barriers are not the only impediment to United States investment overseas. Would-be investors frequently encounter nontax barriers as well. These may include a lengthy and complex application and approval process; specified performance requirements which must be met; local content requirements specifying that goods manufactured by foreign subsidiaries contain certain amounts of local

materials; prohibition of foreign ownership in certain sectors, such as banking, insurance, transportation and the media; restriction of foreign equity participation to a certain percentage; joint venture requirements; restrictions on repatriation of capital or profits; exchange controls; employment restrictions, such as a ban on employment of expatriates or requirements that a certain percentage of foreign nationals be employed; and restricted access to credit in the host country.

Such restrictions are most frequently encountered in developing countries, where the national governments are likely to be deeply involved in directing and controlling economic activity. It is in these countries where American companies seeking to invest most need the cooperation and support of the U.S. Government. Again, we feel that bilateral negotiations are the most effective approach to overcoming investment barriers.

An effort by the Office of the U.S. Trade Representative to negotiate a Bilateral Investment Treaty with the government of Egypt has been underway for some time. Among other objectives, this treaty is intended to ensure national treatment by both governments. We support the investment treaty concept as a viable instrument for achieving equitable treatment of U.S. investment abroad, expecially in the developing countries. We also commend the Reagan Administration's commitment to raising the priority of overseas investment issues, as evidenced by the appointment of an Assistant U.S. Trade Representative for Investment Policy.

There are increasing signs that developing countries are becoming more and more open to foreign investment. Many lack the capital necessary to finance economic development. Understandably, however, they want some assurance that foreign investment will benefit their economies, while investors in turn want an environment conducive to profitable business ventures and protection from expropriation. Investment treaties appear to be the best method for providing such mutual assurances.

U.S. Government impediments to U.S. direct investment abroad

Our discussion of national treatment would be incomplete if it did not point out that the United States Government has not in all respects provided for national treatment of its own business community. Curiously, some government policies impacting overseas investment by American companies have resulted in far less equitable treatment of such investment than the treatment extended to inflowing investment of foreign corporations.

These policies, such as taxation of Americans working abroad, have placed U.S. companies at a comparative disadvantage in competing in the international economy. We know that steps are being taken to deal with this and other similar problems, and we applaud them. We view such efforts as encouraging signs that Congress and the Administration recognize the need for positive measures to restore U.S. competitiveness, rather than restrictive actions to guard against foreign competition. We hope they are only the first in a series of efforts to strengthen the international position of U.S. business.

The job of restoring U.S. international competitiveness in foreign trade and investment involves not only removing existing disincentives, but also providing new incentives which match those of our international competitors. One such incentive which merits support is the U.S. Trade and Development Program. The program has been particularly valuable in identifying and planning development projects abroad which can result in expanded U.S. exports and investments during project implementation.

We cannot emphasize too strongly the need for the U.S. Government to maintain its new-found international perspective as it fashions trade and investment policy. We must preserve our own policies of openness and neutrality and be aggressive in encouraging other countries to do likewise. We cannot allow shortsightedness, economic isolationism, and a failure to recognize the interaction between economic and political policy to recreate the disadvantages and disincentives which confront us today. Only through continued sensitivity to the new order of worldwide economic interdependence will we make genuine progress towards rekindling U.S. competitiveness in the international economy.

EXHIBIT—U.S. TAX TREATIES

The United States, as of June 30, 1981, has income tax treaties in effect with the following countries:

- Antigua [1]
- Australia
- Austria
- Barbados [1]
- Belgium
- Belize [1]
- British Virgin Islands [1]
- Burundi [2]
- Canada
- Denmark
- Dominica [1]
- Falkland Islands [1]
- Finland
- France
- Gambia [1]
- Germany
- Greece
- Grenada [1]
- Hungary
- Iceland
- Ireland
- Italy
- Jamaica [1]
- Japan
- Korea
- Luxembourg
- Malawi [1]
- Montserrat [1]
- Netherlands
- Netherlands Antilles [3]
- New Zealand
- Norway
- Pakistan
- Poland
- Romania
- Rwanda [2]
- St. Christopher, Nevis, and Anguilla [1]
- St. Lucia [1]
- St. Vincent [1]
- Seychelles [1]
- Sierra Leone [1]
- Sweden
- Switzerland
- Trinidad and Tobago
- Union of South Africa
- U.S.S.R.
- United Kingdom
- Zaire [2]
- Zambia [1]

[1] 1958 extension of the United Kingdom treaty.
[2] 1959 extension of Belgian treaty.
[3] 1955 extension of The Netherlands treaty.

U.S. INVESTMENT ABROAD

A tax commitment for

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President
William R. Brown

One of the principal purposes of the Federal Finance Committee of the Council of State Chambers of Commerce is to contribute to a better understanding by legislators as well as the general public of the need for rational and fair rules for the collection of tax revenues in the United States.

The Council takes pleasure in recommending this study, the principal purpose of which is to describe the importance of foreign investment and trade to the United States economy and to explain the need for continuation of Internal Revenue Code provisions which make the Code neutral in regard to the taxation of foreign source income.

We are sure that readers of the study will find it a useful addition to their knowledge of the subject and a helpful tool for clarifying the purposes of the foreign source income provisions of the Code. It is hoped that such a clarification will be effective in eliminating some misconceptions about these provisions which have been evident to the Council for many years.

Sincerely yours,

William R. Brown

William R. Brown
President

Foreword

Chapter I of this booklet was authored by Professor Robert G. Hawkins, Assistant Dean, New York University Graduate School of Business Administration, to whom the Council of State Chambers of Commerce and Price Waterhouse express their deep appreciation. The remaining chapters were prepared by Price Waterhouse in conjunction with an ad hoc committee composed of representatives from the Council of State Chambers of Commerce.

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Contents

CHAPTER I

The importance of U.S. investment abroad for the American economy

Introduction

During the post-war period, U.S. policy has been to encourage international trade and facilitate international investment by U.S. companies. This liberal policy position was based upon two presumptions. One is that freer trade and investment, as long as fairly and reciprocally implemented, improves the international allocation of resources and raises domestic economic well-being by increasing productivity and lowering prices. The second was that higher levels of international private investment would aid the development of friendly poor countries, and would complement and perhaps substitute for official development assistance.

The result has been dramatic. Facilitated by technological revolutions in international communications and transportation, this policy stance has made international trade expand at a faster rate than U.S. and world production; and has allowed foreign investment by national companies to expand even faster than trade. For example, from 1950 to 1978, the value of world production (in current prices) grew at an average rate of about 7%; world trade expanded at annual rates of over 9%, while foreign production of U.S. companies grew at almost 11% per year.

This growing international interdependence has been accompanied by relative domestic economic prosperity in the advanced industrial countries, including the United States. Yet, in the past twenty years, the U.S. has lost international market share in exports, has been exposed to growing competition from imports, and has not kept pace with many industrial countries in growth in income per capita. This has led to a questioning of the appropriateness of a liberal trade and investment policy for the U.S. economy, and has fueled protectionist and restrictionist sentiments in organized labor and some industries.

This chapter focuses on foreign investment by U.S. companies and makes two basic points. First, foreign investment and production by U.S. companies is good for the American economy overall, and has not contributed significantly to the economic ills often attributed to it. Second, U.S. tax policy with respect to U.S. investment abroad has been approximately "neutral," and could not undergo major change without adverse economic consequences for the domestic economy.

The impact of U.S. foreign investment on the domestic economy

The magnitude of U.S. direct investment abroad is substantial. At the end of 1978, the estimated book value of U.S. company investment abroad was $168 billion; by the end of 1979 the total was $193 billion. This compares with an investment of $41 and $51 billion by foreign companies in the United States on the same dates. U.S. investment abroad increased by about 140% from 1970 to 1979–a rapid rate of growth even after discounting for inflation.

In 1978, about 45% of U.S. foreign investment was in manufacturing industries; almost 20% was in petroleum; 9% was in other extractive industries; and about 27% was in services. The analysis which follows applies mainly for manufacturing, since this sector is the focus of controversy over its impact on domestic employment, competitiveness, and the balance of payments. U.S. foreign investment in services, petroleum, and other extractive industries is rarely viewed as having any significant adverse domestic economic consequences.

Over 70% of U.S. investment abroad is in the advanced countries, and almost one-third of that in Canada alone. This leaves only 30% of total U.S. investment in developing countries, and here a handful of countries–e.g., Mexico, Brazil, Taiwan, and South Korea–account for the bulk.

While foreign investment by U.S. companies is large in absolute terms, it is more modest when compared with the U.S. economy.[1] Table 1 shows the net outflow of capital (including retained earnings in foreign affiliates) and the total capital spending abroad by U.S. companies, both compared to domestic business investment in the United States. The final two columns show each expressed as a percent of domestic business investment. In 1978, the capital outflow for foreign investment was equivalent to 6.9% of domestic fixed investment, and that percentage has been falling since the mid-1970s. Total capital spending by U.S. foreign affiliates, which includes not only the capital outflows but also foreign borrowing by those affiliates, was equal to 12.6% of domestic investment. This ratio has also fallen since 1975, and both ratios are little different from their levels in the late 1960s and early 1970s.

These findings are consistent with those of the *Business International* (1980) survey of 97 large U.S. multinationals. For the manufacturing companies in that sample, the share of fixed assets of the companies held outside the United States rose from 20% in 1970 to 26.7% by 1977, but

[1] The figures are official Department of Commerce estimates found in the *Survey of Current Business* (various issues).

Table 1

Foreign involvement of U.S. companies relative to fixed investment in the United States, 1960-1978

Annual average	Foreign direct investment flow	Fixed capital expenditure by majority-owned foreign affiliates of U.S. companies	U.S. business investment	(1) and (2) as a % of (3)	
	(Billions, $)	(Billions, $)	(Billions, $)	(Percent)	
1960-1962	2.77	4.0	48.7	5.7	8.6
1966-1968	5.30	9.1	84.3	6.3	10.8
1970-1972	7.88	15.0	107.1	7.1	11.7
1975	14.35	27.0	148.7	9.7	18.7
1978	16.70	30.7	243.5	6.9	12.6

Source: U.S. Department of Commerce, *Survey of Current Business*, various issues.

remained almost constant in 1978. Thus, the idea that U.S. companies are recently accelerating their foreign activities *relative to domestic operations* is not borne out by the data. Foreign investment and production in manufacturing is rising at a rate similar to that onshore.

The economic effects of foreign investment on the domestic economy take several forms. It may be helpful to review the process of foreign investment so as to identify the possible economic impacts.

Foreign investment occurs when a U.S. company raises some capital in the United States and increases its production facilities abroad–through expansion of existing facilities, building a new plant, or acquiring a foreign company. It then produces goods or services, employing local labor and other inputs, and often utilizes technologies developed in the United States and perhaps U.S. technical and managerial labor. The output of the foreign affiliate may be sold in the local market, exported to third countries, or exported back to the United States. The net revenue earned by the foreign affiliates will go partly to pay local taxes, may be retained for further expansion abroad, or may be remitted to the U.S. owners. The economic impact of this process on the U.S. economy is thus:

- *A balance of payments effect*
- *An impact on domestic production in the United States*
- *A change in domestic U.S. employment as a result of changing U.S. production levels*
- *An impact on the profits of the investing U.S. companies*
- *An impact on U.S. tax revenue.*

It should be noted that the critics of U.S. foreign investment focus their attention on the presumed displacement of U.S. jobs and production, and often ignore positive effects arising in the other areas identified above. There appears to be no vocal clientele to make the positive but unheralded case that foreign investment is good for the balance of payments and good for the profitability of U.S. companies.

As will be emphasized below, the net outcome of these effects may differ widely from company to company and from project to project, and will depend ultimately on whether the U.S. companies could have served the market in question from their United States facilities. The weight of the evidence indicates that, in most cases, the companies could not have captured or retained the markets in question and thus the net overall economic impact for foreign investment on the U.S. economy is positive, even if difficult to observe. We turn now to some of that evidence.

Direct financial flows in the balance of payments

While American companies send funds abroad, they also receive major return flows in the form of dividends, interest and license and management fees. The $168 billion of existing foreign investment generates an impressive net financial flow for the U.S. balance of payments. This is shown in Table 2, for 1978, and for the cumulative period 1970-1978. For all foreign investment, the net positive direct financial flows were $73 billion for the period 1970-1978, of which foreign investment in manufacturing

Table 2

Direct financial flows relative to U.S. foreign investment, 1970-1978

(Billions, $)

	All sectors		Manufacturing	
	1978	**1970-1978**	**1978**	**1970-1978**
Gross outflow of equity and intra-company lending	4.6	37.2	1.0	15.8
Remittances of interest, dividends, and branch profits	13.6	83.4	4.4	24.3
Remission of fees and royalties	4.8	27.0	2.8	15.9
Net direct balance-of-payments impact	+ 13.8	+ 73.2	+ 6.2	+ 24.4

Source: Survey of Current Business, August 1979.

contributed about one-third. In 1978, the manufacturing contribution was almost one-half.

While these figures should not be construed to indicate that foreign direct investment is unequivocally good for the U.S. balance of payments, they do suggest that any adverse impact in the trade accounts would have to be significant to offset the positive effect of the financial flows. In addition, they imply that foreign investment is likely to pay for itself *in the long run*–at least in balance of payments terms.

The effects on U.S. foreign trade

While the direct financial flows associated with U.S. corporate investment abroad are visibly and definitely positive for the balance of payments, the impact of that foreign investment on U.S. exports and imports is also of critical importance in determining the overall effect on the balance of payments, and more important, on U.S. domestic production and employment. While net positive financial flows may be viewed favorably by stockholders and managers of U.S. multinationals, if these are associated with negative impacts on exports, imports, and domestic production, the economy and the balance of payments may be harmed overall even though those groups are benefitted.

When U.S. companies begin producing abroad through a foreign corporate affiliate, the potential impact on U.S. trade may take four forms.

1. The domestic supply linkage

Building and equipping the foreign production facility will result in higher exports of building materials and supplies, and of engineering services. In addition, foreign affiliates tend to order a large share of their equipment needs from the parent company or other U.S. suppliers. Earlier estimates (for the 1965-1973 period) indicate that at least 40% of the initial fixed investment by U.S. manufacturing affiliates abroad are spent on imports of equipment, materials, and services from the United States (U.S. Department of Commerce, 1969).

2. Sales to the local market

The output of foreign affiliates of U.S. manufacturing companies are mainly to the local market in which the affiliates operate. Official data and survey evidence indicates that 75-80% of the sales of foreign affiliates of U.S. companies are to the local market. Whether such sales help or harm exports from the United States revolves around one issue–could that local market have been supplied from the United States via exports. The answer depends on the trade and investment policies of the host country, and on the competitive environment in the industry. It is well known that many countries establish import barriers to force foreign companies to invest and produce locally. It has also been demonstrated that there are now more effective competitors with U.S. companies for world markets in almost every manufacturing industry in 1980 than there were in 1950 or 1960.[2]

[2] For evidence on this point using market share and industry concentration ratio, see Vernon (1974) and Dunning and Pearce (1975).

Since such a major share of sales by U.S. foreign affiliates are to the local market, the total impact of foreign investment and production on U.S. trade is dominated by the assumption or assertion about the percentage of such sales which could have been made from the United States. If it is assumed, as is frequently done by critics of foreign investment, that most or all of these sales could have been made from an American production base, the inevitable conclusion is that foreign investment harms U.S. exports, production and employment overall. But such an assumption does not recognize the realities of the international competitive environment in 1980. In almost every manufacturing industry, there are fewer U.S. companies among the largest five (or ten) companies in that worldwide industry in 1975 than in 1965. U.S. companies are thus facing intensifying competition from larger and stronger foreign companies (Dunning and Pearce, 1975).

Companies invest abroad, not because they want to, but for one of two reasons. One is that the expected higher profits, due to lower costs, which the investment would allow is high enough to overcome the company's inertia and offset the higher risk, so that the investment is undertaken to the benefit of the company and the harm of the U.S. economy. The other is that the investment is undertaken to lower costs so as to be able to gain or preserve the market from lower cost suppliers from Japan, Europe, or even the developing countries. The rise since 1950 in the number of effective foreign competitors to U.S. companies in virtually every industry, together with the consistently shrinking share of U.S. companies in each industry in the world market, is strong evidence that the preponderance of foreign investment by U.S. companies is of the latter kind. That is, the foreign investment is largely defensive in nature, designed to preserve or raise market share in the face of intensifying foreign competition. This being the case, the foreign sales of affiliates do not displace exports because, in large measure, the markets could not have been served from a U.S. export base. In short, most of the exports would have been lost anyway, but to foreign suppliers rather than to foreign affiliates of U.S. companies.

3. *Stimulation of exports through foreign affiliates*

Foreign production units of U.S. companies obviously utilize some raw materials, components, and spare parts supplied from the United States. But the fact that a company has a foreign "presence," with established sales and service networks, raises sales of product lines from the United States which are not produced in the foreign affiliates. This serves to *stimulate* exports from the parent company, and the existence of this positive effect has been analyzed and documented in several studies.[3] Most U.S. multinationals are multiproduct firms, and frequently make some product lines only in the United States–for competitive reasons. Other lines are made abroad–again usually for competitive reasons. The sales and service efforts are more effective when a producing subsidiary exists

[3] For example, Lipsey and Weiss (1972), Horst (1974), Hawkins (1972) and Business International (1980).

than when exports are attempted through local distributors, sales agents or sales subsidiaries alone. In 1978, the manufacturing companies in the Business International sample sold almost one-quarter of their exports of finished products through their foreign affiliates (amounting to $5.6 billion). This effect is a positive one for U.S. exports, and for U.S. production and jobs.

4. Sales from U.S. foreign affiliates to the U.S. market

A possible negative impact on U.S. trade is the import of products produced abroad by U.S. companies to serve the U.S. market—whether cars, electronics, or chemicals. This phenomenon has received considerable attention, yet must be kept in perspective. First, the magnitude of such imports, although rising, remains quite small. In 1966, U.S. manufacturing affiliates abroad shipped slightly over 6% of their total production to the United States; by 1977 this had climbed to just under 10%. Another indication is that, for the manufacturing companies in the Business International sample, imports from their foreign affiliates accounted for only 3.4% of their total U.S. sales in 1978. Overall, the magnitude of the apparent problem is relatively small, although concentrated in certain industry sectors.[4]

Second, for these imports back to the U.S. to have a negative effect on U.S. trade (and production), it must also be true that the U.S. companies could have retained the sales from domestic production sites, in the face of competition from imports from non-U.S. companies. Given the policy of relatively unrestricted trade, some U.S. companies in, for example, electronics or automobiles, have found that their presence in the U.S. market could only be maintained by producing some products abroad and exporting them to the United States. Again, how important this defensive competitive reaction becomes is a matter of assumption and assertion, but the international competitive environment is such as to make a strong case that many of those imports could not have been competitively supplied from onshore production facilities.

The overall balance of payments effects

Putting together the disparate effects and evidence outlined above, what is the conclusion? On an annual-flow basis, the financial activities of U.S. multinationals are definitively positive. The impact on U.S. trade depends on how much of the foreign production of U.S. companies would have been carried out at home. If, as we believe, a substantial majority of that investment is to defend market share from foreign competitors, then the trade effects are also positive, or at best only slightly negative. Overall, then, the balance of payments would be favorable over the longer term.

Several econometric studies have been carried out to estimate the effects of U.S. manufacturing investment on the balance of payments. This has sometimes taken the form of estimating a "pay-back" or break-even period, during which the initial capital outflow is counterbalanced by net

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[4] Furthermore, these aggregate ratios of imports to foreign production or U.S. sales may be distorted by trade in autos and automotive products which have been greatly affected by the Canadian-United States Automotive Agreement.

receipts on financial or trade accounts. An early noteworthy effort indicated that the pay-back period is in the range of 8 to 17 years, depending on the assumption of whether the foreign investment replaces domestic investment (Hufbauer and Adler, 1968). A more recent estimate by Choi (1980), utilizing data through 1978, indicated that the pay-back period is 5-6 years. These more sophisticated estimates are consistent with the data presented above, all of which suggest that the operations of U.S. companies abroad are, on balance, a positive influence on the U.S. balance of payments and trade.

U.S. production and employment

There is no doubt that U.S. multinationals close plants, move facilities abroad, and change the international pattern of production and trade. Indeed, multinational firms are among the most dynamic firms in the economy:[5]

- *U.S. multinational firms tend to have, on average,* higher *growth rates in domestic U.S. production and in U.S. employment than the average for all manufacturing.*
- *Such companies have a higher level of research and development expenditures and employees relative to sales or employment than the average for all U.S. manufacturing.*
- *Such companies export from the U.S. a higher share of their total sales, and have a higher growth rate of exports from the United States than the average for all U.S. manufacturing.*

Yet the charges that U.S. multinationals transfer jobs and undermine U.S. technological leadership persist and have recently intensified.

U.S. multinationals both create new jobs and destroy existing jobs. Several studies have concluded that the total number of jobs created may be more than the number of jobs destroyed.[6] This is a result of the fact that more home office jobs are needed to support foreign operations than domestic production operations, and that new production jobs created through expanded exports are almost equal to the old production jobs destroyed as a result of the cutback in obsolete product lines in the United States.

But more importantly, the characteristics, location, skill requirements, and industry of the domestic jobs created by foreign investment by U.S. companies is *different* from those which are phased out. The workers displaced as a result of foreign production of, for example, light bulbs, do not have the same characteristics, skills, or salaries as the jobs created by that offshore production through better sales and service of products exported by the same U.S. companies—e.g., gas turbines.

Studies have estimated the mix of jobs created versus jobs eliminated by foreign production of U.S. companies.[7] Using the input-out table and the industry skill and wage data, by industry, from the U.S. Labor Depart-

[5] This was documented extensively for the 1960s. See, e.g., U.S. Tariff Commission (1973) and Hawkins (1972). More recent studies reconfirm the findings, e.g., Business International (1980).

[6] See Stobaugh (1972) and Hawkins (1972).

[7] See Hawkins and Jedel (1975) and Webbink (1976).

ment, it was estimated that the average job created by foreign production of U.S. companies carried a salary almost $1,000 higher than the average jobs displaced. The skill mix of jobs created were more heavily weighted in the technical, professional, managerial and clerical ranks while those displaced were more heavily weighted in the skilled and unskilled production worker categories. While those estimates were based on the foreign production of U.S. companies in the late 1960s and early 1970s, recalculation of estimates using data for the mid-1970s indicates that the conclusions remain unchanged.

The overall economic impact

The above analysis and studies cited suggest that foreign investment by U.S. companies are beneficial for the U.S. economy in an overall sense. That does not suggest that some groups and some workers may not be harmed, but that the overall positive effects outweigh the negative impacts.

Multinationals are some of the most dynamic companies in the economy. Their foreign operations have become one of the most intense and direct linkages with other economies, permitting the worldwide exploitation of U.S. technology, and allowing U.S. companies to compete on even terms with ever-stronger foreign companies. To restrict or reduce that ability would have serious negative effects on the U.S. economy, cutting off U.S. companies from the competitive stimulus of foreign markets, reducing further our international competitiveness and stifling productivity growth and innovation.

Foreign investment has had positive effects on the U.S. economy. Almost every serious study concludes that foreign investment helps the balance of payments in the long run. The weight of the evidence also indicates that foreign production by U.S. companies does not erode our export position, and creates more demand for workers than it eliminates. This is true because most foreign investment is a competitive response to foreign companies seeking to capture actual or potential markets, both abroad and in the United States.

Foreign investment is a part of the dynamic response through which American industry adjusts to changing international economic conditions. It provides the opportunity for American workers to have skills upgraded and productivity increased, if retraining is provided. The jobs created pay more and have higher skill categories than those eliminated. To stifle this adjustment would tend to lock American industry into outdated production modes and low productivity activities. This would harm capital formation at precisely the time when higher investment levels are needed to raise lagging productivity growth and improve the international competitiveness of the U.S. capital base.

In addition, foreign production by U.S. companies provides a larger base for and higher return on new technology. If, as is commonly held, new research and development expenditures depends on its expected returns, then restricting U.S. companies to exploit their technology from U.S. production bases would, no doubt, retard the pace of new research and development.

U.S. tax policy and foreign investment

U.S. government policy toward the taxation of foreign income of U.S. companies has been one of approximate "neutrality." More precisely, it has sought to be a policy of "capital exporter neutrality," in which the tax system *per se* neither favors nor penalizes foreign investment over domestic investment, and thus lets market forces determine the investment decisions. Full capital-exporter neutrality implies that a company, looking at two projects–one foreign and one domestic–with the same expected rates of return, would receive the same worldwide tax bill on both, and thus the tax system would not affect the investment decision.

U.S. tax treatment approximates this situation. There are two main elements of note in the U.S. system. One is the U.S. income tax credit for taxes on foreign earnings paid to foreign governments. This credit is limited to the amount which would have been paid in U.S. taxes had the earnings been made in the United States. It thus effectively eliminates double taxation of earnings, but does not reduce the companies liability for taxes on earnings in the United States.

The second is the deferral provision, under which U.S. tax liability on earnings of foreign subsidiaries of American companies does not arise until those earnings are repatriated in the form of dividends to the American parent. This provision stems from the legal view of corporations as "corporate citizens," and that income should not be taxed until the domestic corporate citizen receives the actual payment, regardless of whether the domestic parent company has effective control over the income when earned. The deferral provision has been under attack for some time as "unfair" and for extending more favorable tax treatment to the earnings of foreign affiliates than to domestic companies.

The seriousness of this criticism is often overblown, however. Most industrial countries have profit tax rates that are not very different from the U.S. tax rates. Thus the tax bill for most foreign affiliate earnings has already been taxed by the host country when earned. In some developing countries, where the effective tax rate is sometimes lower than in the United States because of tax holidays and other incentives provided foreign investors, the advantage may be somewhat more significant.[8]

Two additional points are worthy of note. First, the United States does not treat foreign subsidiaries of its companies any more leniently than other major base countries for multinational firms, e.g., Japan, France and Germany. Thus, to apply less liberal tax policy to foreign earnings would place U.S. companies at a competitive disadvantage against foreign based companies.

Second, there remains a major departure from equal, or fully neutral, tax treatment for foreign operations which tends to favor investment in the United States over investment abroad. These are internal revenue code changes of the late 1960s and 1970s, which provide investment tax credits for qualified investments in plant and equipment, and accelerated depreciation allowances for writing off certain fixed assets. These provisions are not available for capital spending and depreciation by foreign

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[8] See Ness (1973).

subsidiaries of American companies. In addition, the provisions for Domestic International Sales Corporations (DISC) also relieves U.S. taxes on a part of earnings by domestic companies involved in exporting. These make the after-tax rate of return on domestic assets more attractive than that on foreign assets yielding the same pre-tax rates of return. Estimates indicate that these provisions are much more important in their impact on the total tax bills of American companies than is the deferral provision.[9] The deferral provision, to the extent that it does provide any lower tax rate on foreign earnings of U.S. companies, may be viewed as a partial offset to the several tax provisions which favor investment in the United States.

Thus at present, U.S. tax policy toward foreign earnings, if one considers the foreign tax credit, deferral provision, and domestic investment tax credit and depreciation provisions is, if anything, biased against foreign investment and not in favor of it. This departure from full neutrality has occurred almost by accident, as provisions of tax credits for domestic capital spending and depreciation on domestic assets were not extended to foreign affiliates of U.S. companies.

Removal of the deferral provision, or changing the nature of the credit provision, would move U.S. tax policy further away from neutrality, and reduce the after-tax rate of return on U.S. investment abroad. Not only would this harm the return flow of dividend remittances, it would reduce the new outflow of foreign investment and lower the future benefits to the domestic economy outlined above–including its competitiveness, jobs and balance of payments. In an economic simulation of the impact of several tax policy changes on foreign investment by U.S. companies, it was found that the likely outcome of elimination of deferral and/or the foreign tax credit provisions would be a very significant impact on companies' returns, and therefore on their willingness to invest abroad (Kopits, 1980).

[9] See Hufbauer (1975) and Kopits (1980).

CHAPTER II

Timing of the taxation of foreign subsidiary earnings (The "deferral" issue)

Under current law, a U.S. corporation which undertakes foreign business operations may choose to structure its operations as:

- *Foreign subsidiaries,* whose earnings are generally subject to U.S. tax only when remitted back to the U.S. parent company; or
- *Foreign branches* of the U.S. corporation, whose earnings are taxable (or losses deductible) in the U.S. on a current basis.

Taxation of foreign subsidiaries

Of the two approaches, however, U.S. corporations normally conduct overseas activities through subsidiaries organized in the countries where the operations are located. Under U.S. tax law, the earnings of such subsidiaries are normally subject to tax when distributed as dividends to their U.S. parent corporation.

From time to time, critics of the present system have contended that the existing approach be changed to subject to immediate U.S. taxation the income of foreign subsidiaries. In effect, these critics advocate a system of anticipatory taxation, which would apply whether or not a foreign subsidiary had adequate cash available to pay a dividend after covering working capital and other investment requirements. Some have referred to such proposals as the "elimination of deferral," a semantic device which implies erroneously that the U.S. government at one time enacted deferral privileges to foster foreign investment.

In fact, the United States system of taxing foreign subsidiary income has developed in accordance with internationally accepted principles of taxation. *No country* has a system in which income earned by overseas subsidiaries and affiliates is currently taxed at home. Nevertheless, pro-

posals to tax currently the earnings of U.S. owned foreign subsidiaries were very seriously considered in the Burke-Hartke Bill of 1972 and recommended by the Carter Administration in 1978. A study of this issue was conducted by a task force appointed by the House Ways and Means Committee, chaired by Representative Rostenkowski in 1977, which concluded that the present U.S. tax ground rules in this area are logical and soundly based and should be retained.

Effect of proposals to currently tax foreign income

If the United States were to change its tax laws to currently tax foreign subsidiary income, the effect would depend on the level of taxes being paid by all foreign subsidiaries in the aggregate. In many countries, the tax rate approaches or exceeds the U.S. 46 percent income tax rate. In such cases, allowable foreign tax credits would result in little or no residual U.S. income taxes.

In countries where the income tax rate is appreciably lower than the U.S. rate, large federal income tax liabilities would arise. This would make it difficult for U.S. companies to compete with foreign businesses in such countries.

It has been argued that termination of deferral would serve to make domestic investment as attractive as investment abroad. In fact, it would appear that the true intent is to strongly discourage foreign investment with the notion that this would lead to increased investment in the U.S. This view clearly ignores that beneficial contributions to the domestic economy (e.g., jobs, exports, balance of payments) made by U.S. controlled overseas subsidiaries. (See discussion in Chapter I.)

Although the acceleration of U.S. tax revenues as a result of anticipatory taxation would probably be marginal on an overall basis, the effect on individual U.S. corporations, as well as on specific business decisions, could be significant. For example, to the extent that business considerations would indicate that investments be sited in countries offering initial tax incentives, imposition of U.S. anticipatory taxation would offset any advantage of such incentives for U.S. corporations. The likely result would be loss of the business opportunity to a foreign-based competitor rather than additional U.S. tax revenues.

Also, in a world of fluctuating exchange rates, varying accounting principles and tax laws, language barriers, etc., there would be very substantial practical difficulties in determining the income of foreign subsidiaries based on worldwide application of the U.S. tax law. The present system, where income is recognized in the U.S. when dividends are remitted, is simple (by comparison) and practical from the standpoint of taxpayers and the Internal Revenue Service alike.

The U.S. tax system provides for the avoidance of double corporate taxation of corporate earnings domestically by eliminating, in whole or in major part, dividends received from other U.S. corporations when determining corporate taxable income. Such elimination does not apply, however, to dividends received from a foreign corporation, unless that corporation carries on its trade or business in the U.S. and is subject to

U.S. tax. Moreover, a foreign corporation's profits and losses cannot be included in a U.S. tax return, with minor exceptions.

Subpart F

The basic principal that a U.S. corporation is not required to recognize income earned by its foreign subsidiary until receiving a dividend from that subsidiary was modified by the introduction, in 1962, of the Subpart F provisions into the Internal Revenue Code. These are very complex provisions and will be treated only summarily in this booklet.

The intent of the Subpart F provisions is to ensure that a U.S. multinational does not employ artificial devices, involving the use of foreign subsidiaries, solely as a means to unreasonably reduce its worldwide tax burdens. Under Subpart F, the U.S. parent company of a foreign subsidiary is taxable on certain categories of income earned but undistributed by such subsidiary. The principal types of undistributed income which can be taxed in this way are lightly taxed investment income, tax haven sales and service company income as well as shipping and insurance income.

Taxation of foreign branches

While it is less common, some U.S. companies operate overseas through foreign branches of domestic subsidiaries. The U.S. tax treatment of such operations is explained in this section.

Under the U.S. Tax Code, domestic corporations, i.e., corporations organized under the laws of a State of the U.S., are liable for U.S. taxation on income from all sources, domestic and foreign. This is known as the worldwide (global) taxation principle. Accordingly, when a U.S. corporation carries on income-producing business activities outside the U.S., through a branch or division located overseas, or otherwise derives foreign income, the income earned abroad will be subjected to U.S. tax. Correspondingly, any losses resulting from an excess of expenses over income attributable to overseas activities are deducted from other income generated by the U.S. corporation.[1] In effect, a foreign branch or division is merely an extension of the U.S. corporation, as opposed to being a separate juridical entity, and the tax rules treat it accordingly. The branch form of operation abroad is commonly used by U.S. banks which are generally required to use branches rather than subsidiaries, and occasionally by other types of U.S. corporations for various reasons. U.S. tax on the income earned by the foreign branch can be reduced or eliminated by electing to claim a credit against the U.S. tax for the income tax imposed by, and paid to, a foreign government.

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[1] Various rulings and cases deal with the recapture of branch losses when the branch is incorporated as a foreign subsidiary.

CHAPTER III

Purposes and application of U.S. foreign tax credit provisions

The nature and purpose of the foreign tax credit provisions of the U.S. Internal Revenue Code ("Code") are often much misunderstood, which fact seems to be in part responsible for the numerous legislative proposals of recent years aimed at limiting the use and effectiveness of the credit for U.S. corporations.

The retention of an effective, undiluted foreign tax credit mechanism is fundamental to the continued growth of U.S. international trade and overseas investment. The attacks on the foreign tax credit appear to stem primarily from a lack of knowledge as to what it is and how it works. It is therefore necessary to dispel the fundamental misconceptions regarding the foreign tax credit. It should be understood that:

- *The foreign tax credit (or its equivalent) is not unique to the United States.*
- *The foreign tax credit does not discourage domestic investment nor does it encourage foreign investment.*
- *The foreign tax credit does not reduce the U.S tax liability on U.S. source income.*
- *The foreign tax credit is not a tax preference or loophole.*

In the material that follows, the basic purpose and mechanics of the U.S. foreign tax credit will be described briefly, with a view toward providing objective support and evidence of the four propositions stated above.

Purpose of the U.S. foreign tax credit

Historically, United States tax policy toward foreign business income has tended to achieve two major objectives: equity among taxpayers (with equity defined roughly as equal treatment for taxpayers irrespective of

income source) and general tax neutrality with respect to foreign versus domestic source income (the absence of U.S. tax penalties or benefits on foreign versus domestic source income). Thus, U.S. tax policy has sought to prevent international double taxation and to minimize the role of taxes as determinants of business location.

The U.S., as well as other countries, recognizes that the foreign country in which income is generated has the primary right to tax such income, and in order to prevent the pyramiding of different layers of taxes on the same income, recognition is required to be given to the income tax imposed by the foreign country. Absent such recognition, confiscatory double taxation would result, and foreign business operations would be drastically curtailed or eliminated. Although the U.S. Code does provide a deduction for foreign income taxes paid by a U.S. taxpayer, experience has proven that a deduction does not adequately relieve the double taxation inherent in multinational operations. For example, if a U.S. corporation pays a 50 percent rate of tax to a source country, deducting such tax would result in a 73 percent overall tax burden, hardly an attractive tax cost to encourage business activities.

To avoid this type of result, most of the industrial nations of the world have adopted one of two systems designed to eliminate this adverse effect. One method is for a country to exempt foreign source business income realized by its nationals (France, Belgium, Netherlands). The other method, and the one which the United States employs (as well as such countries as Canada, Japan, Germany and the U.K.), is to tax worldwide income of its citizens while allowing a credit for foreign income taxes paid.

Accordingly, if the aggregate foreign tax applicable to foreign income, taxable in the U.S., is less than or equal to the U.S. top rate of 46 percent, that income will be subject to a total U.S. and foreign tax of 46 percent. If the aggregate foreign tax rate is higher than the U.S. rate, that income will be subject to a total foreign tax in excess of 46 percent, and no U.S. tax. The *overall limitation*, by its terms, requires the aggregation of foreign taxes and foreign income.

Who can claim the foreign tax credit

Foreign income is any income earned from sources outside the U.S. It may take the form of income attributable to foreign business activities, as well as actual dividends, royalties, rentals and/or interest income received from either foreign affiliates or unrelated foreign parties. It may also take the form of undistributed income of certain corporations, as provided in special rules in the Code (e.g., controlled foreign corporations, DISCs, etc.).

In general, any taxpayer subjected to foreign tax on the above items of foreign income, is entitled to claim the foreign tax credit. This chapter, however, will focus primarily on the credit as it pertains to corporations.

Creditable taxes

Taxes which are available for credit are foreign *income* tax liabilities incurred by a U.S. taxpayer, including foreign income taxes paid by a U.S. business on its overseas business activities as well as withholding taxes deducted at source on payments from abroad of, for example, dividends,

interest and royalties. Additionally, a U.S. corporate shareholder owning at least 10 percent of the voting stock of a foreign corporation may claim credit for an appropriate portion of the foreign income taxes *paid by the foreign corporation* on the earnings out of which dividends are paid to the U.S. corporation (the deemed paid credit).

The foreign tax must be an income tax (or a tax in lieu of an income tax), in the U.S. sense of that term, not a tax which is based on other criteria, such as on gross receipts, sales or value added. These other types of taxes are deductible as expenses if imposed on the U.S. taxpayer, but are not eligible for the credit. The Internal Revenue Service has issued guidelines setting forth its views as to the standards a foreign tax must conform to in order to constitute a creditable foreign income tax. Over the years, the Congress and the courts have evidenced the intention that the foreign tax credit provision be liberally applied, in the interest of fulfilling the original statutory mandate to avoid international double taxation.

The direct foreign tax credit

The term *direct* tax generally refers to a foreign income tax imposed directly on the U.S. taxpayer, including taxes paid on income from overseas business activities as well as foreign withholding taxes deducted from investment-type income. An illustration of the direct foreign tax credit is shown below:

	$
Royalty income from a foreign licensee	100
Foreign withholding tax at 15%	15
Net amount received	85
Included in U.S. income	100
U.S. tax thereon at 46%	46
Less–foreign tax credit	15
Net U.S. tax payable	31

The deemed paid foreign tax credit

As mentioned, a domestic corporation may be entitled to a foreign tax credit for income taxes which it has not itself incurred, but which are treated as if, or "deemed", paid by it. The taxes which are creditable under these rules are the foreign income taxes paid by a foreign corporation on the income from which it pays a dividend to a qualifying U.S. corporation. To qualify, a U.S. corporation must own at least 10 percent of the voting stock of the dividend-paying foreign corporation. Thus, a U.S. parent company receiving a dividend from a foreign subsidiary can credit against its U.S. tax not only the dividend withholding tax but also a portion of the foreign subsidiary's tax on earnings used to pay the dividend, provided that the deemed credit is added to the amount of the dividend for inclusion in income ("gross-up").

In addition, the Code contains rules which permit a flow through deemed paid credit for foreign income taxes paid by corporations indirectly owned (through other foreign corporations) by the U.S. corporate shareholder, provided certain requisite ownership thresholds are satisfied.

The amount of the deemed paid credit is that proportion of the foreign corporation's income tax liability that dividends paid to the U.S. corporation bear to the foreign corporation's total earnings and profits for the relevant year. The following example illustrates the calculation of the deemed paid foreign tax credit, assuming a 50 percent payout.

	$
Earnings before tax of foreign corporation for calendar year 1980	1,000
Foreign income tax at 40%	400
Earnings and profits for 1980	600
Dividend paid to U.S. parent company	300
Less–foreign withholding tax at 5%	15
Net dividend received in U.S.	285
Foreign creditable taxes:	
a. Direct credit for withholding tax	15
b. Deemed paid credit for subsidiary's tax:	
$\dfrac{\text{(Dividend)}\ 300}{\text{(Earnings and profits)}\ 600} \times$ (Foreign tax) 400:	200
Total creditable taxes	215
Included in U.S. income:	
Gross dividend (285 + 15)	300
Plus: foreign deemed paid tax ("gross-up")	200
Grossed-up dividend included	500
U.S. tax at 46%	230
Less–foreign tax credit (above)	215
U.S. tax payable	15

Where the subsidiary is less than wholly owned, the investor's actual proportionate share of the foreign earnings and foreign taxes are used in the formula for determining the amount of credit and gross-up.

Limitation on amount of credit

If a U.S. taxpayer receives income from a foreign country which imposes its income tax at rates higher than in the U.S., the total creditable taxes would exceed the U.S. tax on that foreign income. Accordingly, the Code provides a limitation to ensure that a credit is not available to reduce the *taxpayer's tax on U.S. income*, by restricting the amount of credit which a taxpayer can use in any year to the U.S. tax on its *foreign source*

taxable income. Although excess foreign tax credits which cannot be used in a particular year can be carried back two years and forward five years, in no event can they be availed of to reduce the U.S. tax on U.S. income. For example, if the foreign income tax appropriate to the dividend in the above illustration had been $250, the excess $20 would only be available as a credit against the U.S. tax on foreign source income in a carryover year.

The limitation is applied on a global basis, referred to as the "overall limitation". It results in an averaging effect when income is received from one or more high tax countries as well as one or more low tax countries. This can generally be beneficial, except in years in which the U.S. multinational has foreign operations which resulted in losses (other than losses incurred by separate foreign subsidiaries).

Allocation and apportionment regulations (1.861-8)

To arrive at foreign source *taxable* income for purposes of calculating the limitation, foreign source gross income *must* be reduced by the appropriate amount of expenses incurred and borne by the U.S. corporation in earning that income. In addition, however, to expenses directly related to earning foreign income (e.g., expenses of direct overseas business activities), the IRS also considers indirect expenses, including those incurred in the U.S., to be allocable to foreign income. The type of indirect expenses considered to be so allocable are, among others, general shareholder (investor) expenses, interest expense, and research and development expenses.

The practical application of this concept had presented difficulties for taxpayers for many years, during which time several sets of proposed regulations were issued. A final set of regulations was adopted in 1977 with effect for years beginning after December 31, 1976. The net impact of this regulation has been to reduce, sometimes dramatically, the credit limitation to many U.S. corporations with the resulting increase in their overall tax burdens. In particular, it has had an adverse impact on U.S. based research and development activities by requiring an apportionment of such expenses between foreign and domestic source income. The concepts embodied in the regulation tend to undermine the basis upon which the foreign tax credit system rests.

Conclusion

Although the foreign tax credit has survived reasonably intact over the years, attacks on it from time to time since 1960 have tended to make it more restrictive and less responsive to the need to maintain neutrality by eliminating the adverse effects on international trade arising from international double taxation. It is crucial that the nature and purpose of the credit be thoroughly understood in Congressional circles so as to end the perception that it is a gaping loophole in the U.S. Code. Without the credit, or some comparable relief mechanism, U.S. companies will be unable to compete in international markets, with all the detrimental effects on the U.S. economy that would ensue (as noted in Chapter I).

CHAPTER IV

Need for tax treaties

Background

Bilateral income tax treaties are negotiated and executed by nations for the primary purpose of avoiding double taxation and encouraging the free international flow of investment. In the treaty framework, the contracting parties sacrifice, by agreement, their statutory rights to some tax. Unilateral foreign tax credits and territorial exemptions eliminate double taxation to an extent, but the treaties go further in providing for procedures for allocating the right to taxation of certain types of income between the two jurisdictions. In addition, treaties provide for significant reductions in the rates of statutory withholding taxes, which is significant in many cases, since these taxes are usually charged on gross income and there is a limit to the amount of foreign tax credit on the resulting net income that can be absorbed by the recipient. The negotiations themselves provide the tax authorities with a useful forum for cooperation and discussion of tax problems in the international area. In some cases, where local tax law is not clear, it helps the foreign investor to be able to rely on a treaty as regards a particular transaction.

For a capital-exporting country using the foreign tax credit system, such as the U.S., it is important to obtain a reduction in foreign tax from treaty partner countries to ensure that, as far as possible, the foreign tax burden does not exceed the U.S. tax on foreign income.

Although all tax treaties are bilateral and thus tailored to the facts, circumstances, aims and laws of the two nations involved, there has been a movement, particularly over the last 15 years, to standardize the treaties through the drafting of models by international organizations. The most recent model is the Draft Double Taxation Convention on Income and Capital of 1963, as last revised in 1977, developed by the Organization for

Economic Cooperation and Development (OECD). This Draft Model Convention and its commentaries have become a basic document in guiding national negotiators and their tax advisors in this important area of avoidance of double taxation of international business and investment.

Most of the many treaties now in force have been concluded between developed countries, which tend to be both capital exporting and capital importing and thus have common interests in such areas as reduction of withholding taxes on foreign investment income and royalties. Fewer treaties have been concluded between developed and developing countries because the latter are primarily capital-importing nations with different objectives and goals. It is interesting to note, however, that, resulting from recent East-West trade discussions, bilateral tax treaties were negotiated and executed between various governments of Western countries and the Soviet bloc nations.

U.S. treaty program

The provisions of a U.S. tax treaty generally override the provisions of the federal income tax laws. Although the U.S. treaties generally take precedence over the provisions of the federal income tax law, however, they generally do not at present extend to state and local taxes. It is thus not uncommon for income of a foreign corporation with some activities in the U.S. to be exempt from Federal income tax under a treaty but to be subject to an income tax in one or more of the states. The U.S./U.K. treaty, signed in 1975 and ratified in 1980, originally attempted to influence state taxation by preventing states from applying the so-called unitary basis of assessment to U.K. controlled multinational groups. The attempt did not succeed as the U.S. Senate would not approve such a provision.

Negotiations with other countries are undertaken by representatives of the U.S. Treasury Department. The procedure is for the negotiators to agree on a treaty and to sign it. The signed treaties must then be ratified by the respective governments before they come into force. In the U.S., each treaty must be approved by the Senate and there are a number of treaties which the U.S. has signed but which were, for various reasons, not ratified by the Senate and eventually withdrawn.

The more recent U.S. tax treaties are based on the OECD Model. In 1977, the U.S. Treasury issued its own "model income tax treaty" representing the provisions which the U.S. would seek to have included in a U.S. treaty. The U.S. model broadly conforms to the OECD Model with some modifications for specific U.S. positions. A revised U.S. Model was issued in June, 1981.

Treaties with developing countries

The U.S. has an extensive network of tax treaties with the developed countries of the world. However, the U.S. has fallen behind many other European nations in successfully negotiating treaties with developing countries. This has principally been due to the fact that the U.S. has steadfastly refused to offer to the developing countries a so-called "tax sparing" credit, in accordance with which the U.S. would grant a foreign

tax credit for taxes of a developing country that would have been paid but for a local tax holiday. At the moment, however, the U.S. is finding the developing nations more receptive to treaty negotiations because of their pressing need for foreign investment, particularly U.S. investment.

General pattern of U.S. treaties

Recent U.S treaties contain articles addressed to the following areas, which are discussed in more detail in the appendix:

- Scope of treaty
- Definition of treaty terms
- Industrial and commercial profits
- Taxable income of permanent establishments
- Shipping and air transport
- Affiliated enterprises
- Investment income
- Capital gains
- Individuals
- Double taxation
- Exchange of information

In particular, it should be noted that the article dealing with double taxation recognizes the U.S. foreign tax credit and supports it as a tool to eliminate international double taxation. Moreover, the articles dealing with affiliated enterprises and exchange of information serve to prevent abuse situations in the intercompany transfer pricing area.

APPENDIX CHAPTER IV

Description of typical U.S. treaty provisions

Scope

The initial articles generally define the taxes and persons covered by the particular treaty. In the case of the U.S., only federal income taxes are covered, but in the case of other countries local taxes on income are often included as well.

Definitions

The treaty next defines its terms and provides that any term not defined shall be interpreted under the laws of the country whose taxes are involved. The definitions include the various concepts of fiscal domicile and residence, terms which are of significance in determining the applicability of the treaty to items of income and the persons receiving them.

One of the most important definitions relates to the term "permanent establishment," which broadly means a branch, with limitations and extensions which vary from treaty to treaty to cover the many possible variations of activity and contact in a country by a foreign enterprise. The existence or absence of a permanent establishment affects principally the taxation of these activities.

Industrial and commercial profits

In the absence of a treaty, a U.S. enterprise with relatively inconsequential activities in a foreign country could become subjected to that country's tax. For instance, a U.S. corporation, merely selling goods to customers in a foreign country, could, depending on that country's tax laws, be considered taxable there with the threat of double taxation.

To avoid double taxation arising in cases where an enterprise is doing business *with* rather than *within* another country, the tax treaties generally provide for full exemption from tax in the host country. The treaties generally provide that industrial and commercial profits earned by a U.S. enterprise in the partner country will not be subject to tax in that country unless the U.S. enterprise maintains a permanent establishment in that country to which the income is attributable. If the activities amount to a permanent establishment, they are subject to tax under the country's normal rules, and double tax relief will generally be available only by means of the U.S. foreign tax credit.

The treaties contain slightly varying definitions of permanent establishment. However, a permanent establishment is generally present if manufacturing operations are carried on in the treaty country or if a sales office is maintained there. On the other hand, if the U.S. enterprise is merely exporting goods to the other country, it is generally possible to avoid having a permanent establishment by using an independent local commission agent to negotiate on its behalf, as opposed to maintaining an employee or exclusive agent in the other country.

Taxable income of a permanent establishment

Subsequent articles provide for the computation of taxable income when a permanent establishment exists. The basic principle followed is that the foreign enterprise is to be taxed on the income attributable to the permanent establishment as if it were a distinct and separate enterprise, dealing with its head office on an independent arm's length basis. Provision is made for head office expenses to be allocated where these are incurred for the specific benefit of the establishment or for the benefit of the group as a whole.

Shipping and air transport

The treaties generally provide for taxation of income from shipping and air transport in the country where the enterprise is headquartered or resident for tax purposes, and for exemption in the other country. Some treaties simply provide for exemption from tax for ships and aircraft registered in the other country.

Affiliated enterprises

The treaties provide that where enterprises are affiliated or under common control, their respective profits shall be determined on an arm's length basis. Recent treaties also provide for consultations between the governments when there are conflicting rules on this matter which result in double taxation.

Investment income

The treaties provide for a reduction in the withholding taxes on dividends, interest, royalties and rentals. These reductions are intended to give recognition to the fact that the withholding taxes imposed at source are based on gross income and thus require a reduction to take into consideration the expenses of earning the income as well as in the interest of avoiding double taxation.

In the case of dividends, the withholding tax rate is usually reduced to 15 percent in the case of portfolio investments, i.e., individual investors and corporate investors with insubstantial holdings. Such investors would normally be able to claim a foreign tax credit for the withholding taxes. In the case of substantial holdings, however, the rate is generally reduced to 5 percent, on the basis that the income is still within the corporate group. Substantial holdings for this purpose vary, but 10 and 25 percent are the most common in the recent treaties.

In the case of interest income, a withholding of tax at source on gross, without recognition of the fact that the recipient has incurred interest expense, can result in excessive taxation. Most treaties between developed countries have recognized this problem and exempt interest from withholding tax entirely, in order to encourage fast and free flows of investment funds across borders. Some treaties limit the tax to 5 percent or 10 percent.

Royalties have similarly been exempted at the source in many treaties between developed countries, in the interest of encouraging the flow of know-how between their countries. Many treaties include equipment rentals and know-how payments in the royalty exemption. Industrial as well as cultural royalties are usually covered.

Real estate income and natural resource income are treated differently from the other kinds of investment income. The country in which the properties are located is given the right to tax the income. However, the recipient is sometimes given the choice of being taxed on a net income basis (at graduated rates) rather than a gross income basis (at a flat rate), in recognition of the heavy expenses usually associated with such income.

The new U.K. treaty contains an anti-avoidance provision which is also contained in the U.S. Model. The provision excludes certain holding or investment companies owned by third country nationals from the benefits of reduced rates on investment income. This is to combat the phenomenon known as "treaty shopping."

Capital gains

Except for real property and effectively connected assets, the treaties usually provide an exemption from the capital gain taxation of one country for residents of the other country. Thus, under most treaties a U.S. investor would not be subject to capital gains tax in the other country.

Individuals

The treaties usually provide for exemption from tax for visiting employees of enterprises of the other country, in addition to visiting directors, self-employed persons, students, trainees, teachers and government employees. There are also provisions to avoid the double taxation of pensions and for the prevention of tax discrimination against nationals of the other country.

Double taxation

Most treaties contain specific provisions to relieve cases of double taxation which might arise despite the treaty provisions. For example, the U.S. normally reserves the right to tax its nationals and corporations in full, but agrees to allow a foreign tax credit. Although the right to a foreign tax credit is contained in the U.S. statute, it is sometimes provided for in tax treaties, and with an occasional modification.

Most treaties provide for cooperation between the "competent authorities" (tax authorities) of the two governments involved in cases where double taxation might arise contrary to the spirit of the treaty. In the case of the U.S., the Commissioner of Internal Revenue has delegated the administrative functions of the "competent authority" to the Assistant Commissioner (Compliance) and the technical interpretative function to the Assistant Commissioner (Technical). The most typical situation where the competent authority mechanism is effective is in the area of intercompany transfer pricing, where crossborder, affiliated transactions are involved.

Exchange of information

Most treaties contain provisions for the exchange of information between the governments in specifically delineated circumstances. This is an avenue of enforcement that governments are using more frequently in these days of increasing crossborder transactions.

CHAPTER V

Purposes and application of DISC provisions

Purpose of DISC

In 1971, the Congress recognized the need to encourage exports from the U.S., in the furtherance of domestic economic activity. It further recognized that one of the ways to encourage export activities was through the tax system. Accordingly, the Domestic International Sales Corporation (DISC) provisions were enacted at that time, effective in 1972.

The principal feature of the DISC provisions is that some portion of the export-related profits will not be subjected to federal income tax until they are actually or constructively distributed by the company earning them.

Types of DISCs

There are two types of DISCs, a buy/sell DISC and the more widely used commission DISC.

A buy/sell DISC receives orders directly from its customers, takes title to export goods for resale abroad, issues invoices in its own name, and collects accounts receivable from its customers.

A commission DISC earns a commission from participating in an export sale with its related supplier (usually the parent or a sister company), with the supplier continuing to perform all export functions. Ordinarily, the DISC will earn a commission equal to the maximum profit it would be entitled to under special safe haven intercompany pricing rules if it were a buy/sell DISC. The regulations require that the related supplier must actually pay the commission within 60 days after the close of the DISC's year.

Qualification requirements

To obtain the DISC benefits, a non-manufacturing domestic corporation, engaged solely in export activities, must elect to be treated as a

DISC. There are a number of requirements to be met to qualify, the most important of which are these:

Gross receipts requirement

For each year, a DISC must derive at least 95 percent of its gross receipts from the sale or lease of export products manufactured in the U.S. or commissions from such export transactions. Also, certain specified types of interest income will qualify.

Asset requirement

To maintain DISC qualification, 95 percent of the corporation's total assets at each year-end must consist of export inventories, assets used primarily in connection with sale or lease of export inventories, accounts receivable and evidences of indebtedness arising in connection with export transactions, etc.

Taxation of DISC income to shareholders

A DISC, itself, is not subject to federal income tax. Rather, DISC income is taxed in the hands of its shareholders as a dividend when:

- *There is an actual distribution of DISC income;*
- *There is a deemed distribution of DISC income;*
- *DISC status is terminated, or when a shareholder sells his DISC stock and the gain realized reflects his share of untaxed DISC income; or*
- *The DISC pays any foreign bribe or participates in an international boycott.*

CHAPTER VI

Taxation of expatriate employees and the significance to employers

Introduction

The cost of maintaining U.S. employees abroad has climbed dramatically in recent years, primarily due to higher tax burdens, the complexity and uncertainty of the U.S. tax law as well as the administrative burdens thrust upon U.S. employers. This has resulted in a reduction of the number of U.S. expatriates employed abroad. Various industry groups have indicated the adverse effect of such cutbacks upon the level of U.S. exports and overseas business vis-a-vis foreign multinationals. It is for this reason that Congress is again re-examining the tax rules applicable to U.S. expatriates.

In order to persuade an employee to transport himself and his family to another country, a monetary incentive generally must be provided. The employer must provide the expatriate, through various allowances, with the means to reside under conditions similar to which he is accustomed at home, to educate his children as he would at home and to uphold the corporate prestige by living as well as his counterparts in the host country. In addition, the employer must reimburse the expatriate for excess tax burdens arising out of the overseas assignment (the excess of the U.S. and foreign taxes, including social security, over the tax normally paid in the U.S.).

Background to U.S. approach to expatriate taxation

The U.S. approach has been to tax U.S. citizens on worldwide income regardless of source, which is virtually unlike every other nation of the world where taxation is based on residency rather than citizenship. Double taxation on foreign income of U.S. expatriates, as in the case of U.S.

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corporations, is avoided or minimized by the U.S. foreign tax credit. Until 1962, however, U.S. citizens resident abroad were allowed to exclude from U.S. tax *all* earnings for services performed outside the U.S., thus equating them substantially with nationals of other countries.

1962 saw the introduction of a limitation on the earned income exclusion of $20,000 per annum for the first three years of foreign residence and to $35,000 thereafter. In 1964, the $35,000 exclusion was reduced to $25,000. In 1976, the earned income exclusion was reduced to $15,000 and other very severe restrictions were imposed. However, because of the adverse impact of the 1976 amendments on the U.S. taxation of expatriates, particularly their impact on the overseas compensation costs to U.S. employers, the 1976 changes were replaced by tax provisions of the 1978 Foreign Earned Income Act.

The 1978 legislation replaced the long standing foreign earned income exclusion concept with a totally new concept allowing deductions for the excess foreign living costs incurred by U.S. expatriates on foreign assignment, such excess to be measured by comparison to the highest cost urban area within the U.S. The exclusion was retained at a level of $20,000 per year, but only for employees living in camps or compounds (usually employer provided) in designated hardship areas and only attributable to periods during the year when the employee actually resided in such camp or compound.

The 1962 amendments resulted in the filing of tax returns by U.S. citizens abroad, for the first time in many cases. However, the earned income exclusions plus the foreign tax credit still kept U.S. taxes at a minimal level for most U.S. expatriates. Moreover, their foreign tax liabilities were, with some notable exceptions, also maintained at acceptable levels through tax incentives granted by foreign governments and careful tax planning.

Thus, U.S. companies in the 1960's often adopted a very simple policy–high compensation for expatriates. U.S. citizens working in foreign locations were generally paid much better than employees of host country companies, because U.S. salary levels were much higher and it was necessary to use U.S. personnel to promote U.S. business and exports. The tax rules at the time did not necessitate the employers becoming involved in the personal tax affairs of their employees.

Present problems

Today, problems for U.S. multinational employers arise from a combination of factors. Inflation has caused sharp increases in salaries worldwide. As a result, U.S. salary scales are no longer substantially in excess of overseas executive salary scales. The new expatriate taxation scheme, excess foreign living cost deduction rather than a flat earned income exclusion, is not providing the relief anticipated by the supporters of the 1978 legislation, particularly in the housing area, which is the major cost area where foreign living costs exceed comparable U.S. costs, primarily because of technical deficiencies in the legislation itself. For a more

detailed discussion of the current taxation rules and various tax reimbursement plans, see the appendix.

In addition, the IRS is examining more returns of expatriates than ever before, and imposing their restrictive interpretations of the statute to create deficiencies. The constantly changing legislative rules and the higher probability of IRS examination have made the preparation of expatriate tax returns more complex and have forced many U.S. companies to engage outside consultants to handle tax return preparation and tax planning for their expatriates, at not insubstantial costs.

Coupled with all this, foreign income tax rates have increased over the years and enforcement efforts are much more efficient in many foreign countries where U.S. expatriates reside. In addition, the tax authorities in countries with which the U.S. has an income tax treaty can and do ask the U.S. authorities to provide detailed data on U.S. citizens resident in their countries. Foreign social security taxes on individuals are becoming a significant cost in many European countries. Tax incentives available to foreigners with technical skills are gradually being withdrawn or limited.

Trends for the future

In the U.S., there continue discussions of how the income and allowances of U.S. citizens working abroad should be taxed. The current rules result, in the view of business, in too heavy a burden of taxation, borne in most cases by U.S. employers trying to compete with foreign-based multinationals. There is a movement in progress today, manifested by several bills introduced in the Congress, to return to a foreign earned income exclusion approach at levels substantially higher than the maximum exclusion levels contained in the prior law, for both reasons of simplicity and equity. For a detailed discussion of the current rules covering U.S. persons working abroad, reference should be made to "U.S. Citizens Abroad," one of a series of information guides published by Price Waterhouse.

APPENDIX CHAPTER VI

Current employer tax reimbursement plans

Introduction

In an effort to overcome the dilemma of providing monetary incentives for employees to move abroad without having them substantially eroded by taxation, multinationals have developed various arrangements, and thus have become involved in the personal tax affairs of their expatriate employees. Several approaches are briefly described below, the most common being "tax equalization." It is considered by most multinationals that tax equalization meets most of the following objectives for a good plan:

- *It must be fair to both the company and the expatriate and be easily understood by the expatriate;*
- *It must treat employees equally regardless of their geographic location;*
- *It must be structured so as to facilitate overseas transfers from the United States and transfers between two overseas posts; and*
- *It must compare fairly with current practices followed by other major multinationals.*

Laissez faire

Under this approach, the employer pays each expatriate employee a base salary plus the usual allowances, and leaves the employee responsible for paying his U.S. and foreign taxes. This was the approach used by most U.S. companies in the 1950's and early 1960's, which involved the simple technique of providing high amounts of compensation for expatriate employees and letting them handle their own tax affairs individually. This approach is rapidly becoming obsolete today for many reasons.

Ad hoc

Under this approach, the employer deals with each expatriate employee's compensation and tax problems on an individual basis. Any reimbursements of excess taxes would depend on the work location as well as personal factors. This method is suitable for multinationals with only small numbers of employees on international assignment. However, if large numbers of employees are sent overseas, the *ad hoc* approach is unsatisfactory and can result in internal difficulties among employees as well as administrative problems. As multinationals have sent greater numbers of U.S. employees abroad, the *ad hoc* approach has also become virtually obsolete.

Tax protection

Under this approach, the employer reimburses the employee for the excess of the actual foreign and U.S. taxes on his compensation over the tax which he would have paid if he had remained in the U.S. The employee is thus protected from paying higher taxes on a foreign

assignment. If, however, the taxes incident to a foreign assignment are lower than the hypothetical stay-at-home tax, the employee reaps the benefit.

Tax protection is used today by some multinationals. Since, however, the employee is allowed to keep the difference if his actual tax is lower than the stay-at-home tax, there is created a tendency for the expatriate employees in low tax countries to resist transfers, thus restricting flexibility of staff movement. Further, there is an incentive for the employee to seek ways of reducing his local taxes which the company may consider undesirable. The cost of such a plan to the employer is also greater than a full equalization plan, under which an employee is not allowed to keep the difference in a lower tax country. Thus tax equalization has been slowly gaining ascendency.

Tax equalization

Under this approach, the expatriate employee's gross earnings are adjusted so that, in effect, his net after-tax income is what it would have been if he had remained in the U.S., plus the necessary incentive payments and allowances, net of tax. As under the tax protection plan, the employer reimburses the expatriate for the excess of the actual U.S. and foreign taxes over the hypothetical stay-at-home tax. But if the stay-at-home tax is higher than the actual tax, the benefit inures to the employer rather than the employee.

Although this philosophy does cause some complaints by employees assigned to relatively low tax areas where indirect taxes are high, this method (and variations thereof) are now being used by most international employers of expatriate personnel.

The technique for achieving tax equalization is to compute the hypothetical tax and to deduct it from the employee's base salary. Thus the employee's taxable income both for U.S. and foreign tax purposes is reduced by the hypothetical tax, whereas under a tax protection plan the hypothetical tax does not reduce taxable income. Overseas allowances are then added to the base salary reduced by the hypothetical tax to arrive at after-tax disposable income. The employer then reimburses the employee for *all* the actual taxes he incurs, as compared to reimbursing him for only the estimated additional taxes, if any, he incurs under the tax protection plan.

CHAPTER VII

The importance of proper intercompany transfer pricing rules and administration

Introduction

Where an international corporation operates abroad through overseas subsidiaries and affiliates, tax authorities in the various countries concerned, including the corporation's home country, generally view such a situation as presenting the taxpayer with opportunities to shift profits to low tax countries through the use of artificial transfer prices on intercompany sales of goods and services. In response to this perceived problem, tax authorities around the world have tended to react by adopting measures which have, in most instances, restricted this type of tax avoidance activity. The essential need is for a set of transfer pricing rules that is fair and equitable to the adopting government and, at the same time, not overly onerous and burdensome to the affected taxpayers. Overzealous enforcement by the agents of the various tax authorities concerned must be avoided, and reasonableness should be the order of the day, in order to shield multinational corporations from effective double taxation.

The U.S. was one of the earliest to move in the direction of providing taxpayers and tax enforcers with a set of cohesive rules to deal with the many manifestations of intercompany transfer pricing. In fact, many other governments, as well as the OECD, have thoroughly familiarized themselves with our rules as a basis for formulating their own versions. Admittedly, the U.S. rules are far from perfect; nevertheless, they represent an attempt to provide objective criteria to use in evaluating intercompany transfer pricing structures, which have worked reasonably well in practice since they were promulgated as final regulations in 1968.

Section 482 of the Internal Revenue Code is the basis for government regulation of intercompany transfer prices. It has been in the U.S. law for over forty years. The section is one sentence in length and provides the

IRS with broad powers to allocate income and deductions among and/or between related businesses to more clearly reflect income and prevent tax evasion.

For some years, the IRS employed Section 482 only in extreme situations of income shifting among domestic taxpayers. During the decade of the 1950's, however, U.S. corporations greatly accelerated their business expansion abroad, establishing overseas manufacturing, sales and licensing companies. In some cases, corporate taxes abroad were lower than the U.S. corporate tax, and thus there were advantages to accumulating profits abroad.

To stem any tendency for profits to be shifted from the U.S. to foreign subsidiaries, the IRS, in 1961, instituted a vigorous enforcement program in the area of international operations, focusing principally on the reallocation powers of Section 482. In order to avoid retroactive adjustments and unanticipated deficiencies, U.S. taxpayers have generally sought to comply with the principles developed under this section. In regulations issued in 1968, practical guidelines were established as to how the Commissioner's broad authority under this section will be applied to the allocation of income and deductions, with particular emphasis on cases involving foreign income. These regulations and related rulings have generally accomplished their objective.

Scope and purpose of Section 482

U.S. Section 482 can apply in any case where two or more incorporated or unincorporated organizations, trades or businesses are controlled directly or indirectly by the same interests. The "reality" of the control is considered to be decisive and not its form or mode of exercise. A presumption of control may arise if income or deductions have, in fact, been found to have been arbitrarily shifted.

Allocations can be made not only to prevent "evasion of taxes" but also where considered necessary to "clearly...reflect the income" of each enterprise or group. The regulations emphasize this point by stating that an allocation can be made even where a shifting of income has occurred by inadvertence.

The overriding concept is one of strict recognition that each corporate entity within a controlled group is separate and distinct from other members of the group. The objective of the section is to determine the income of each separate entity as if it had conducted its affairs with other members of the group under the same terms and conditions generally applied in business dealings with non-related parties. This is commonly referred to as the "arm's length" principle. The regulations provide guidelines of how the IRS would expect related taxpayers to deal with each other on an arm's length basis, and in some instances also provide exceptions to this standard in the form of safe haven or formula approaches.

Methods of allocation

Where the IRS proposes to make an allocation under Section 482, the allocation can take the form of an adjustment to gross income, deduc-

tions, credits, tax basis of assets for depreciation or for gain or loss purposes, or any other adjustments required to reflect the substance of transactions. There is no authority under the section to disallow deductions or credits, but only to reallocate them among members of a group. In some cases, however, the reallocation of a deduction (e.g., to a foreign affiliate) is tantamount to disallowance in the current year.

The regulations provide that where the IRS has made an adjustment to one member of a group, a corresponding adjustment must be made to other members involved, whether it is a U.S. or foreign corporation. In addition, intercompany pricing adjustments are sometimes made on transactions involving two foreign affiliates of a U.S. corporation, with constructive dividend consequences to the U.S. parent.

Procedures under tax treaties[1]

The income tax treaties to which the United States is a party generally provide for the allocation of income and deductions on transactions between related persons in accordance with the arm's length standard. The treaties also generally show recognition of the problem of international double taxation arising from allocations when countries have different concepts of what constitutes arm's length dealing, and thus provide for settlement of taxpayer grievances by consultation between the "competent" tax authorities of the countries involved. However, these procedures have offered relatively limited usefulness in resolving conflicts in this area.

Specific guidelines

The U.S. regulations under Section 482 offer guidance on five specific types of intercompany transactions:

- *Intercompany loans and advances;*
- *Performance of services by one affiliate for another;*
- *Use of tangible property of one affiliate by another;*
- *Use or transfer of intangible property;*
- *Intercompany sales of personal property.*

Today, U.S. corporations, in hopes of avoiding subsequent reallocations which can lead to unanticipated tax liabilities, are in general attempting to follow the principles outlined in the guidelines, which are discussed in the appendix.

Effectiveness of the U.S. regulations

If it is assumed that Section 482 will continue to be vigorously enforced by IRS in transactions involving foreign affiliates (which is a safe assumption), the issuance of detailed regulations in 1968 must be considered helpful to both U.S. taxpayers and the U.S. Government. The regulations provide objective guidelines and safe haven ranges for interest on intercompany loans and rentals for tangible property. Even in situations

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[1] See chapter on "Need for tax treaties" for a generalized discussion of tax treaties, including the U.S. treaty program.

where they do not provide precise, objective guidelines, the regulations describe IRS' philosophy on the subject and put taxpayers on notice with respect to the concepts which will underlie the IRS examination approach. Moreover, it is unlikely that a more precise definition of "arm's length" could be issued, given the complexity and diversity of business transactions.

The alternative methods for evaluating prices on sales of personal property are more imprecise and ambiguous in practice than is immediately apparent. All three methods highlighted in the regulations and attached summary place heavy reliance on the availability of comparative data, both from within and without the organization, to establish arm's length standards. Similarly, the regulations dealing with service charges are complex because of the requirement to include a wide range of indirect costs.

The regulations do not take into consideration the tax status of charges and allocations in the other jurisdiction and to that extent take the approach that the U.S. concepts should prevail. These questions may receive more attention in cases which are brought up for the consideration of the competent authorities under tax treaties. There have also been cases in which IRS auditors have sought to ignore the regulations and apply their own concepts of evaluating intercompany transactions.

APPENDIX CHAPTER VII

Detailed guidelines contained in Section 482 regulations

Loans and advances

Where moneys are advanced by one member of the group to another, interest will be imputed to the lender *unless an arm's length rate of interest is charged.* However, if the lender is not in the finance business, effective with loans made on or after July 1, 1981, interest at a rate in a safe haven range from at least 11 percent to not more than 13 percent will be treated as arm's length if the taxpayer does not choose (which he may) to use the true arm's length rate. If the interest does not fall in this safe haven range, an allocation at a 12 percent rate will be made by the IRS.[2] The safe haven approach does not apply where the lending affiliate borrows funds at the situs of the borrowing affiliate (i.e., generally in the same country) for relending to the borrowing affiliate, nor does it apply on post-July 1, 1981 loans or advances denominated in foreign currency.

The safe haven approach has proved useful to U.S. corporations making loans to foreign affiliates, thereby avoiding questions of what a proper arm's length rate should be in specific circumstances, and avoiding the question of whether the market rate of the lender's country or the borrower's country should be used. It is clear, however, that safe haven rates will not be acceptable to most other countries and will not form the basis of an internationally acceptable solution, as witnessed by the refusal of the OECD, in its recent report on transfer pricing, to endorse safe havens. Thus, as more countries adopt intercompany transfer pricing guidelines, it is likely that they will apply their own arm's length standards, leaving an international corporate group in the position of having to institute proceedings under the competent authority mechanism of tax treaties to avoid double taxation.

Performance of services

If a U.S. taxpayer performs marketing, managerial, administrative or technical services for the benefit of one or more affiliates, or for the joint benefit of itself and other affiliates, without charge, or at less than arm's length charge, an allocation may be made.

The regulations make a distinction between 1) services which are intended to be of direct benefit to an affiliate either in its day-to-day activities or in its overall direction, and 2) services so indirect or remote that an unrelated party would not have paid for the services. No allocation is required if the expenses are more in the nature of appraisal of the operations or financial condition of an affiliate.

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[2] The safe haven range is 6%-8% for loans outstanding prior to July 1, 1981. A 7% allocation rate will be used if the interest charged is outside the safe haven range.

The rules provide that the amount of the charge for services is to be equal to the *cost* of rendering the services, unless the rendering of such services is an integral part of either party's business, in which case the intercompany charge must include a profit. The concept of cost is not as simple as it sounds since it includes not only all direct expenses identified specifically with a particular service, such as salaries and traveling expenses of employees performing the services, but also any indirect costs which relate to the direct costs.

If the services rendered by or to an affiliate are an integral part of either affiliate's business activity, the charge for the intercompany service must be made at an arm's length rate and thus include a profit element. This would also apply in cases where both affiliates are in the business of rendering similar services to unrelated parties. A profit must also be included when the services are rendered by a company whose principal activity consists of the rendering of such services to related parties.

Use of tangible property

If a U.S. taxpayer transfers possession or use of tangible property to an affiliate at no charge or at less than an arm's length charge, an allocation may be made by the IRS to reflect an arm's length lease or rental arrangement.

If either party is in the business of leasing that kind of property to unrelated parties, an arm's length rental is required. If neither company is in the leasing business, a rental based on a prescribed formula is considered to be acceptable. The formulary rental charge is based on the sum of 1) depreciation computed on a straight-line basis, 2) 3 percent of the original basis of the asset, and 3) current operating expenses, other than interest. As with interest on intercompany loans, the taxpayer retains the right to establish an arm's length rental not based on the formula, but based on marketplace criteria.

Use or transfer of intangible property

Where an interest in intangible property is transferred or made available to an affiliate for other than an arm's length consideration, the IRS is authorized, by the regulations, to make allocations reflecting an appropriate consideration.

Intangible property includes patents, trademarks, trade names, brand names and similar rights. The arm's length consideration should be in a form which would normally be adopted between unrelated parties, and could be in the form of royalties based on the transferee's output, sales, profits or any other measure, lump-sum payments or any other form, including reciprocal licensing rights. The allocation is to be effective at the time the interest in the property is transferred or made available by the developer affiliate to the transferee affiliate.

No objective guidelines, safe haven rates or a range of rates are provided by the regulations to assist in arriving at an arm's length sale consideration or royalty. As an alternative to compensating the developer of intangible property for the right to use the property once it has been developed, a group of related entities can enter into a written "cost sharing" agreement, under which the costs and risks of development can be shared by two or more affiliates in return for each being entitled to a specified interest in any property which may be produced.

Since all parties to such an agreement are sharing costs and the risks, no profit element is involved in the charges, which are simply reimbursements of expenses incurred by those parties who incur more than their allocated share thereof. This method may be particularly suitable for companies engaged in continuing research and development of many different products. It should be noted, however, that the provision for cost sharing arrangements merely shifts the problem from the valuation of intangible property to an allocation of expenses based on a determination of benefits from a corporate R&D program to companies in the group.

Sales of personal property

One of the most important areas in intercompany transfer pricing relates to prices charged for goods sold between affiliates. If goods are sold to an affiliate at less than an arm's length price, an allocation is called for. An arm's length price is the price which an unrelated party would have paid under the same circumstances for similar property. The U.S. regulations prescribe three acceptable methods of pricing goods and the circumstances under which they may be used. The three methods will be briefly described below. There is also set forth a fourth method for use if the three prescribed methods are inappropriate, considering all the facts and circumstances.

The taxpayer does not have the choice of which method to use, because it is required that the comparable uncontrolled price method be used if there are comparable uncontrolled sales. This is considered to be the most accurate estimate of an arm's length price, being based on sales to, or purchases from, unrelated parties. If it does not apply, the resale price method must be used next, because it is considered the second most accurate method, being based on outside customer sales. If certain requirements under the resale price method are not met, the taxpayer may use the cost-plus method.

Comparable uncontrolled price method

The comparable uncontrolled price is the price prevailing when buyer and seller are unrelated. This includes not only a price charged *by* a U.S. corporation to its outside customers, but also a price a U.S. corporation or any member of the group *pays* when buying from an unrelated supplier. It would also include prices on comparable sales between two other unrelated parties. Sales are comparable if the physical property and circumstances involved are the same or close enough so that ascertainable numerical adjustments can be made, e.g., for place of delivery. The price could be affected by circumstances such as quality of the product, terms of sale, intangibles involved, time of sale, level of the market and geographic market in which the sale takes place. Whether these and other differences render the price noncomparable depends on the facts and circumstances of each case.

Accordingly, sales made to unrelated customers in one country would not necessarily be comparable to sales made in another country or countries. Sales of similar products by other, unrelated companies might provide a comparable price if the other factors such as quality and intangibles are comparable. In practice, however, the terms of the sale to unrelated customers provide strong evidence of an uncontrolled price.

Resale price method

The resale price method is applicable to a manufacturer selling to a related sales company which in turn sells to an outside customer. The price of goods sold by the manufacturer affiliate to the selling affiliate is established by working back from the actual resale price charged to the customer and reducing this resale price by a markup commensurate with the functions performed by the selling subsidiary. Under this method, the taxpayer has to determine an appropriate profit margin (the markup) for the selling affiliate in order then to determine the appropriate invoice price from the manufacturer affiliate to the sales company. The markup for the selling subsidiary is the missing factor in this method and may be determined on the basis of factors both internal and external to the business.

Cost-plus method

The cost-plus method starts with the manufacturer affiliate's costs and adds an appropriate markup to arrive at its selling price. Under this method, the manufacturing costs are presumed to be determinable and the markup percentage or amount has to be established by looking first at internal and then at external trade factors. This method would normally be used if the sales company adds substantial value to a product which it has bought from the manufacturer.

State organizations in the Council are:

Alabama Chamber of Commerce
468 South Perry Street
P.O. Box 76
Montgomery, Alabama 36101

Arkansas State Chamber of Com.
911 Wallace Building
Little Rock, Arkansas 72201

Colorado Assoc. of Com. & Ind.
1390 Logan Street
Denver, Colorado 80203

Connecticut Business & Ind. Assn.
60 Washington Street
Hartford, Connecticut 06106

Delaware State Chamber of Com.
1102 West Street
Wilmington, Delaware 19801

Florida Chamber of Commerce
311 S. Calhoun St.
P.O. Box 5497
Tallahassee, Florida 32301

Georgia Chamber of Com.
1200 Commerce Building
Atlanta, Georgia 30303

Illinois State Chamber of Com.
20 North Wacker Drive
Chicago, Illinois 60606

Indiana State Chamber of Com.
Board of Trade Building
Indianapolis, Indiana 46204

Kansas Association of Com.
and Industry
500 First National Tower
Topeka, Kansas 66603

Kentucky Chamber of Com.
Box 817, Versailles Rd.
Frankfort, Kentucky 40602

Louisiana Association of Business
& Industry
P.O. Box 3988
Baton Rouge, Louisiana 70821

Maine State Chamber of Com.
One Canal Plaza - Box 65
Portland, Maine 04112

Maryland Chamber of Com.
60 West Street
Annapolis, Maryland 21401

Michigan State Chamber of Com.
501 S. Capitol Avenue
Lansing, Michigan 48933

Minnesota Assoc. of Com. & Ind.
480 Cedar Street
St. Paul, Minnesota 55101

Mississippi Economic Council
Standard Life Building
P.O. Box 1849
Jackson, Mississippi 39205

Missouri Chamber of Com.
P.O. Box 149
Jefferson City, Missouri 65101

Montana Chamber of Com.
P.O. Box 1730
Helena, Montana 59601

New Jersey State Chamber of Com.
5 Commerce Street
Newark, New Jersey 07102

Business Council of New York
State, Inc.
150 State Street
Albany, New York 12207

Ohio Chamber of Com.
820 Huntington Bank Building
Columbus, Ohio 43215

Oklahoma State Chamber of Com.
4020 North Lincoln Boulevard
Oklahoma City, Oklahoma 73105

Pennsylvania Chamber of Com.
222 N. Third St.
Harrisburg, Pennsylvania 17101

South Carolina Cham. of Com.
1002 Calhoun Street
Columbia, South Carolina 29201

Greater South Dakota
Chamber of Com.
P.O. Box 190
Pierre, South Dakota 57501

State Chamber Division
Tennessee Taxpayers Association
1070 Capitol Hill Bldg.
Nashville, Tennessee 37219

East Texas Chamber of Com.
P.O. Box 1592
Longview, Texas 75601

South Texas Chamber of Com.
6222 Northwest Interstate 10
San Antonio, Texas 78213

West Texas Chamber of Com.
P.O. Box 1561
Abilene, Texas 79604

Lower Rio Grande Valley
Chamber of Com.
P.O. Box 975
Weslaco, Texas 78596

Virginia State Chamber of Com.
611 East Franklin Street
Richmond, Virginia 23219

West Virginia Chamber of Com.
1101 Kanawha Valley Building
P.O. Box 2789
Charleston, West Virginia 25330

Wisconsin Mfrs. and Commerce
111 E. Wisconsin Avenue
Milwaukee, Wisconsin 53202

and cooperating organizations in other states

The CHAIRMAN. Let me say that these hearings will be continued in September at a date to be announced. We will be pursuing this subject further.

Thank you again for being with us.

The subcommittee will stand in recess, pending the call of the Chair.

[Whereupon, at 12:15 p.m., the subcommittee adjourned, subject to call of the Chair.]

U.S. POLICY TOWARD INTERNATIONAL INVESTMENT

MONDAY, SEPTEMBER 28, 1981

UNITED STATES SENATE,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
OF THE COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:50 a.m., in room 4221, Dirksen Senate Office Building, Hon. Charles McC. Mathias (chairman of the subcommittee) presiding.

Present: Senator Mathias.

The CHAIRMAN. The subcommittee will come to order. This is what we hope will not be blue Monday, despite Mr. Granville's predictions.

U.S. policy has long been to encourage the removal of barriers to international flows of capital and profits, as well as trade. Trade and investment are inseparable parts of doing business internationally. A free market for the international flow of capital as well as goods will yield far more jobs in the long run than attempts by government to allocate capital flows through regulations or subsidies.

I have been concerned about the tendency of foreign governments to resort increasingly to restrictive policies toward U.S. and other international investment entering their country, and I am equally concerned about the possibility of the United States overreacting to the rapidly growing foreign investment here.

This morning's hearing is the second in a series being conducted by the Subcommittee on International Economic Policy as part of our review of U.S. policy toward international investment, both U.S. investment abroad and foreign investment within the United States.

The first hearing, which was held on July 30, focused on the use by foreign governments of combinations of tax incentives or of other kinds of subsidies, and of performance requirements which demand certain portions of local content or employment or ownership or exportation of the final product. We can all appreciate and sympathize particularly with the desire of developing countries to acquire capital, to acquire technology, and to increase their international trade competitiveness, but these objectives cannot be met by government fiat, nor can the United States ignore the adverse impact on U.S. trade caused by restrictive and distorting policies toward investment.

Such policies are especially galling when they are pursued by countries whose industries are already mature competitors in the world economy.

Canada's Foreign Investment Review Act and national energy program are harbingers of trade and investment conflicts which could

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too easily lead to higher levels of protectionism around the world. Open markets just don't happen. To achieve and preserve them, we must resist protectionist measures, and encourage our trading partners to do the same.

The United States is not blameless in this regard. Just last spring the Japanese Government decided to restrain automobile exports to the United States in the face of several bills then pending in Congress that would have imposed mandatory limits. These restraints can have harmful side effects on the United States as well as on Japan. They tend to limit consumer choice. They tend to raise the cost of the product, and they tend to reduce the competition which spurs both domestic and foreign industries to achieve greater efficiency, and I think this is true as well for restraints that nearly all the developed countries apply to imports of clothing from developing countries. If the United States is to exercise leadership in promoting free trade and free capital movements, it must avoid protectionist steps in the future, although the pressure for such steps can be very real and very strong and sometimes very appealing, because of the kinds of pressures that local communities feel at a given moment.

The challenge facing us is to work for the elimination of barriers to trade and investment on a global basis. A common effort is required if we are to avoid the dangers of protectionism and create a strong and healthy United States and international economy. Serious consideration should be given to a North American Common Market for Trade and Investment, and to an international investment and services trade agreement along the lines of the existing General Arrangement on Trade and Tariffs [GATT].

Only by moving more vigorously toward more open markets can we overcome the insidious slide toward retaliation or the emulation of restrictive foreign economic policies. But as I say, this has to be a common effort. There shouldn't be any illusion on the part of our trading partners around the world that the United States can maintain open markets unilaterally while seeing our own goods and services exports prejudiced in foreign markets. That, of course, is the nature of the beast, that when you close one market in one place, it always presupposes that other markets in other places will also close.

So, I hope our witnesses this morning will advise the subcommittee on how best to stimulate movement toward a more open international economy.

Our first witness is Dr. Gary C. Hufbauer, deputy director of the International Law Institute of the Georgetown Law Center. Dr. Haubauer.

[Mr. Hufbauer's biographical data follows:]

Biographical Data of Gary Clyde Hufbauer

offices

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Chapman, Duff and Paul, Suite 1200, 1730 Pennsylvania Avenue N.W., Washington, D.C. 20006, Telephone: (202) 624–8872.

education

Harvard College, A.B., 1960 (economics).
King's College, Cambridge, England, Ph. D., 1963 (economics).
Georgetown University Law Center, J.D., 1980.

EMPLOYMENT

Assistant Professor; Associate Professor; Professor; Department of Economics, University of New Mexico, 1963–1974.

Director, International Tax Staff, Office of Tax Analysis, U.S. Treasury, 1974–1976.

Deputy Assistant Secretary, International Trade and Investment Policy, U.S. Treasury, 1977–1980.

Deputy Director, International Law Institute, Georgetown Law Center, 1980 to present.

Counsel, Chapman, Duff and Paul, 1980 to present.

CONCURRENT POSITIONS

U.S. Treasury Consultant, 1965–1967.

Harvard Development Advisory Service, Pakistan, 1967–1969.

Harvard Center for Population Studies, Summer 1971.

Visiting Professor, Cambridge University, Fall 1973.

Visiting Professor, Stockholm School of Economics, Spring 1974.

Adjunct Professor, Georgetown University, Spring 1975.

Advisory Committee, Council for International Exchange of Scholars, 1976–1979.

Editor, OTA Papers, U.S. Treasury, 1976.

Adjunct Professor, Georgetown Law School, 1980 to present.

Adjunct Professoı, Georgetown School of Foreign Service, 1980 to present.

PRIZES AND SCHOLARSHIPS

John Williams Book Prize, 1960.

Phi Beta Kappa, 1960.

Marshall Scholarship, 1960–1963.

Ford Foundation Faculty Fellow, 1966–1967.

Stanford Summer Institute in Urban Economics, 1972.

Fulbright Research Scholar, England, 1973.

PERSONAL

Born: April 3, 1939; San Diego, California.

Married: Carolyn Revelle, June 26, 1961.

Children: Randall Clyde Revelle (July 14, 1965); Ellen Arabelle Scripps (January 12, 1969).

CLUBS

Harvard Lampoon, Cosmos Club, Gibson Island Club, United Oxford and Cambridge University Club.

STATEMENT OF GARY CLYDE HUFBAUER, DEPUTY DIRECTOR, INTERNATIONAL LAW INSTITUTE, GEORGETOWN LAW CENTER, WASHINGTON, D.C., AND COUNSEL, CHAPMAN, DUFF & PAUL

Mr. HUFBAUER. Thank you, Mr. Chairman.

My remarks this morning are made in a personal capacity and not on behalf of the International Law Institute or private clients. Your subcommittee, Mr. Chairman, is well aware of the worldwide spread of government intervention in the investment process which is done in the name of increasing benefits derived by host countries from foreign investment. The consequences for the U.S. economy of foreign government intervention in the investment process have been explained by previous witnesses before this subcommittee. Therefore, I would like to go forward and speculate on some of the policy options available to the United States.

One policy option is simply to do nothing, or at most to confine any response to the rhetorical level. "If it ain't broke, don't fix it" and

"Don't just do something, stand there", or, "Don't just stand there, undo something" are popular slogans today. U.S. corporations have been seeking and accepting investment incentives for years. Performance requirements imposed through a government apparatus such as FIRA or informally agreed upon between the corporation and a foreign government have been a fact of life for quite some time.

Many observers of this scene think that the best response is simply to let the market work. According to this view, foreign governments do not have an endless cornucopia of benefits at their disposal. Benefits given to some firms invariably impose costs on other firms. Therefore, at some point the majority of firms and individuals will realize that more intervention means more taxes or higher costs, and a natural reaction will set in.

In short, the market will punish the interventionists, and to a certain extent this is probably happening in Canada today. Those who believe that the United States should let the market work in dealing with this problem might go on to suggest that we should let the Labor-Industry Coalition for International Trade [LICIT] or a similar voluntary association design and implement an appropriate code of conduct. Then they might say if a joint labor-industry group cannot design a code of conduct, is there any reason to think that U.S. corporations would want congressional restraints on their overseas behavior?

In other words, do firms really want new legal limitations placed on their ability to accept foreign incentives or to submit to foreign performance requirements?

These arguments that I have just gone over are strong arguments for a policy of inaction, and in the end they may very well prevail. But I see two problems with leaving the problems to the market or to voluntary organizations such as LICIT.

First, any solutions may be a very long time in coming. In the meantime, many U.S. firms will very probably lose foreign markets and the United States may very well be tempted to emulate the worst in foreign government policies.

The second difficulty with the inaction approach is that solutions reached would probably not address the negative effect of foreign performance requirements on those U.S. firms and workers that are not a party to the negotiations with the foreign governments.

For these two reasons, I am not attracted by a policy of inaction. The remaining policy options can be grouped into three categories, multilateral, bilateral, and unilateral measures. In my view, only unilateral measures will afford an effective response. In the interest of time, I will pass over both the multilateral and bilateral options, and turn to the unilateral measures.

The Chairman. I should have said to you, Dr. Hufbauer, that of course your full statement will appear in the record, notwithstanding the fact that you may summarize it in your delivery.

Mr. Hufbauer. Thank you very much, Mr. Chairman. I appreciate that.

Turning to the unilateral measures, I use this label to cover actions which the United States may take, consistent with its international commitments, that would offset the effect of interventionist investment policies conceived by foreign nations. It seems to me that well-

designed unilateral measures will impose carefully scaled costs on host governments that take the initial objectionable actions. The art in designing unilateral measures is to fashion remedies that do not over-react, that do redress the injury caused, that penalize the offender, and that minimized the harm to innocent parties.

The most difficult part of this prescription is to minimize the harm to innocent parties. In our trade laws—the escape clause, countervailing duty, antidumping duty, and similar measures——

The CHAIRMAN. That is a part of the subject that gets a lot of sympathetic attention here in Capitol Hill, because the injured parties show up very quickly, and can make very real and appealing cases for some kind of relief.

Mr. HUFBAUER. Yes. And I believe there is often a justifiable claim by the injured parties. I am just pointing out that invariably when one imposes one of these redress measures, countervailing duties, for example, there will be some innocent parties on the wings who will be affected as well.

The CHAIRMAN. To transfer the injury.

Mr. HUFBAUER. To transfer part of the injury, at any rate. The trick in designing relief measures, in my view, is to minimize the transfer, but I don't think it can be entirely avoided.

I would characterize the unilateral measures in terms of who holds the right of action, namely, in terms of purely public response, a mixed public-private response, and a purely private response. In my view, different responses are required for different dimensions of this investment intervention problem. A public response involves retaliation initiated by the U.S. Government. Such a response lies within the discretion of the Executive, with no private party participation beyond the normal opportunity to petition the Government for relief. One avenue available for a public response to the intervention policies of foreign governments is section 301 of the Trade Act of 1974. Under section 301, the President can respond to acts of foreign governments that are inconsistent with the provisions of existing trade agreements, or that are unjustifiable, unreasonable, or burden or restrict U.S. commerce. A proposed bill by Congressman Schulze would clarify this section 301 to assure that the President can protect U.S. investment interests as well as trade interests.

Using this public policy type of response, the U.S. Trade Representative has initiated preliminary steps for a section 301 complaint against Canadian performance requirements imposed by the Foreign Investment Review Agency. Further, I believe the President has resurrected a proposed bill that was rejected by Congress during the Carter administration that would provide "mirror" or copycat restrictions on the tax deductibility of U.S. advertisers on Canadian broadcasting media.

In my view, these are steps in the right direction, but I think the armory of public responses at the disposition of the President should be suitably enlarged.

This subcommittee has authored amendments to OPIC legislation that would deny OPIC support to projects burdened with performance requirements in a manner that would reduce U.S. trade benefits. Similarly, I think that Eximbank, Commodity Credit Corporation, and foreign military sales support might be withheld from countries that encumber firms with certain types of performance requirements.

Likewise, U.S. approval or disapproval of World Bank and Regional Development Bank loans might be partially conditioned on the country's adherence to an open trade and investment regime.

Finally, new investment in the United States from countries that restrict national treatment or rights of entry might be restricted on a case-by-case basis. But, Mr. Chairman, I do not think that the answer lies simply in adding to the range of Presidential thunderbolts. After all, the President can do all of these things anyway if he is disposed.

I am suggesting that explicit statutory language to broaden Presidential powers might be helpful. But inevitably the decision of the President and his officials in cases that involve a purely public response will be heavily influenced by political factors, and almost invariably these political factors will militate against taking firm action.

Second, in this purely public mode of response, the petitioner has little control over the proceedings after they are entrusted to the executive branch, and that necessarily means that claims can and do languish for long periods of time. The third drawback which follows the second is that the petitioner usually has little to say in the remedy that is fashioned, and it may turn out to be a remedy that doesn't redress the problem of which he initially complained.

So, while purely public responses have their role, I do think one has to consider other unilateral measures. I now turn to the mixed public-private response.

A mixed public-private response could be patterned after the model-of-escape clause relief in the Trade Act of 1974. In this model, the private petitioner controls the proceedings up to the determination of harm and the initial design of the remedy, but the President would determine what remedy, if any, would finally be granted, subject to congressional override.

If the Congress wished to design a mixed public-private right of action response to these performance requirements, section 201 could be amended to provide that the President must take action within a set period of time if a private party demonstrates harm to its interests. Let me give an illustrative case. The U.S. Government might then bring a GATT case that an export performance requirement should be treated as the functional equivalent of an export subsidy, and unless the GATT issued a definitive ruling within a set period of time, that the export requirement was not a violation of the subsidies code or the GATT itself, or unless the President made a determination in the national interest that relief was not appropriate, a countervailing measure would be imposed.

The countervailing measure could be directed against imports of the particular product. Alternatively, it could be directed against a much broader range of goods imported from the offending country for the purpose of raising a fund to compensate the private party. As a different approach, the International Trade Commission could recommend that OPIC, Eximbank, or similar programs be withdrawn by the President if negotiations did not produce satisfactory redress.

Mr. Chairman, in my judgment, a mixed public-private response along these lines with appropriate statutory deadlines should be made available for virtually the whole range of performance requirements identified in testimony before the subcommittee. Further, I think an

explicit range of remedies should be enunciated that goes beyond the sorts of trade remedies now set forth in section 301, with an admonition that the International Trade Commission and the Executive should fashion a remedy that adequately compensates but does not overcompensate for the harm caused to the petitioner. At the same time, the remedy should offer the foreign country an incentive for productive negotiations.

I might note, Mr. Chairman, that section 337 does have some of the elements of the sort of solution I am suggesting. However, section 337 historically has been used for patent infringement and foreign monopolization cases, and the 337 remedy is limited to excluding foreign goods from the U.S. market. Finally, section 337 has been addressed to unfair practices engineered by private firms rather than state practices.

For this assortment of reasons, I think refinements of section 301 represent the better approach.

In my written statement, Mr. Chairman, I touch upon some of the secondary but imporant problems relating to the burden of proof and discovery that would have to be addressed in a mixed public-private type of response.

There are some kinds of performance requirements, for example, in the realm of local equity ownership requirements or forced transfer of technology requirements that are at the threshold of defined rules of "fair" and "unfair" practice. In these frontier areas, I think the Executive should retain considerable discretion over the handling of cases within the context of the mixed public-private response that I have described. At the other extreme, there are some practices which in my view are ripe for private action along the lines of the countervailing duty and the private antitrust suit.

I would now like to turn to those practices. Before turning to those practices, I would note that the countervailing duty action evolved from a purely public response to a private response over a long period of time. I think we are in that evolutionary phase with respect to some of the performance requirements which you have identified, and it is time to move along to the private right of action.

As you know, Mr. Chairman, many U.S. business firms have advocated legislation that would almost automatically impose various forms of the reciprocity on foreign investors in the United States. Under legislation of this sort, a "mirror" would be applied to the requirements that a host government imposes on U.S. investors and similar requirements would then be imposed, at the instigation of a U.S. petitioner, on firms from that country that invest in the United States.

In my view, the time is not yet at hand to legislate a purely private right of action along these lines as an answer to investment restrictions that limit ownership levels or require the disclosure of technology. I think we need more experience with these restrictions, and the success of a mixed public-private right of action, before turning to a purely private right of action, such as some of these bills have suggested.

On the other hand, there are cases where a host government imposes export requirements and the exports are shipped to the United States. In those cases, I think a purely private right of action is now

appropriate. It seems to me the private remedy should be available whether the exports are shipped by a U.S.-controlled firm, a third country-controlled firm, or a domestic firm

It is true that a U.S. manufacturer can already file a petition under the countervailing duty statute in just such cases. However, in filing an action, he would face three barriers: One, demonstrating injury, assuming that the country was a member of the Subsidies Code; two, showing that there was a bounty or grant; and three, establishing the amount of bounty, grant, or subsidy in question.

Congress could eliminate, or at least could greatly reduce, two of these barriers to the private right of action by defining a bounty or grant to presumptively include performance requirements, and by establishing a presumptive minimum subsidy. For example, a performance requirement might be presumed to be the equivalent of a 10-percent subsidy unless the company subject to the requirement could demonstrate by clear and convincing evidence that any benefits received were worth a lesser amount. In other words, I am suggesting in this area that a substantial shifting of the burden of proof would be in order.

A more difficult situation is posed in those cases where performance requirements lead to export sales in third countries. Even though those exports might diminish the export markets for competitive U.S. producers, no U.S. countervailing duty could be imposed on the foreign goods. In cases like that, I think the time is at hand to think about different forms of remedies than we traditionally have used. We traditionally have used remedies that act on imports at the border. But in a case such as the one described, Congress could provide a remedy in terms of an award of money damages that would be carefully limited by statute as to presumed duration of loss of sales and other dimensions, perhaps to be paid out of a low rate tariff covering a wide range of goods shipped to the United States from the foreign nation.

Let me emphasize that I am not suggesting anything like the private treble damage antitrust action. I am suggesting a carefully scaled compensatory action. Similar private rights of action might be created against host government requirements that production contain a certain percentage of local content, or a certain value of local sourcing. Again, a money damage approach funded by a low rate tariff could be considered.

I would envisage in such cases that the Executive simultaneously would bring action under the GATT or the appropriate code, and that time limits would provide an opportunity for GATT remedies to be exhausted before the private remedy took place.

In conclusion, I would suggest that this committee should proceed with its study of carefully tailored legislation that would enhance mixed public-private rights of action and create purely private rights of action. I think this legislation would give a very considerable push to stalled multilateral and bilateral talks which I covered in an omitted portion of my remarks, especially if the legislation provided that the rights of action would be suspended with respect to countries that negotiated appropriate standstills and phaseouts of these performance requirements. Equally important, however, additional

remedies would provide carefully measured redress to parties harmed by interventionist policies.

I might note in concluding, Mr. Chairman, that I am aware that many of our States provide very ample investment incentives. I have not yet heard of a State conditioning its investment incentives on performance requirements, but it is possible that some States have done just that. Nor have I heard so far of Federal performance requirements. But logical consistency requires that if we complain about foreign performance requirements, foreign governments also can complain about any performance requirements that are imposed either by the Federal Government or by our States. And while logical consistency is not always followed in trade matters, I would urge that it be followed in this instance. Federal or State performance requirements found in violation of the GATT, the codes, or other international obligations should be invalidated.

Mr. Chairman, that concludes my prepared remarks. Thank you very much.

[Mr. Hufbauer's prepared statement follows:]

Prepared Statement of Gary Clyde Hufbauer

Mr. Chairman, my name is Gary Hufbauer. I first became concerned with performance requirements when, as Deputy Assistant Secretary in the Treasury Department from 1977 to 1980, I worked on the multilateral negotiation of the Subsidies/Countervailing Measures Code and participated in bilateral talks with Canada on automotive investment incentives. More recently, at the International Law Institute, Andrew Samet and I have reviewed the whole range of Canadian-American investment issues, a subject which is heavily colored by performance requirements.[1] In my private law practice, these issues have also been raised. My remarks this morning, however, are made in a personal capacity and not on behalf of the International Law Institute or private clients.

Your Subcommittee is well aware of the worldwide spread of government intervention in the investment process, done in the name of increasing the benefits derived by the host country from foreign investment. Intervention often involves the wholesale departure from rights of establishment, national treatment, and most-favored-nation treatment vis-a-vis foreign firms. Among the requirements imposed on foreign firms are minimum export levels, local sourcing levels, research and development targets, offset and coproduction requirements, domestic equity participation, repatriation of profits limitations, and so on. These restraints are often coupled with incentives such as permission to invest in the first instance, followed by subsidies, tax incentives and access to lucrative protected markets or government contracts.

The consequences for the U.S. economy of foreign government intervention in the investment process have been explained by previous witnesses before the Subcommittee, and I need not restate the basic facts. Instead, it is my intention to speculate on some of the policy options available to the United States.

INACTION

One policy option is simply to do nothing, or at most to confine any response to the rhetorical level. "If it ain't broke, don't fix it" and "Don't just do something, stand there" are popular slogans. After all, U.S. corporations have been seeking and accepting investment incentives for years. Performance requirements, either imposed through a government apparatus such as the Canadian Foreign Investment Review Agency, or informally agreed upon between the corporation and a government ministry, have long been a fact of life.

Many observers believe that the best response to these distortions is simply to "let the market work." According to this view, foreign governments do not

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[1] Gary Clyde Hufbauer and Andrew James Samet, "Investment Relations Between Canada and the United States," paper prepared for the Atlantic Council, August 1981.

have an endless cornucopia of benefits at their disposal. Benefits given to some firms invariably impose direct and indirect costs on other firms. Thus at some point the majority of firms and individuals will realize that more intervention means more taxes or higher costs. A natural reaction will set in, and the inducements that entice foreign firms to accept performance requirements will eventually run dry. In the meantime, if the performance requirements become too inhospitable, firms will shelve their investment plans or even sell their foreign operations. In short, the market will punish the interventionists. To a certain extent, that process is already happening. For example, new flows of U.S. foreign direct investment in Canada are contracting.

Those who believe that the United States should "let the market work" might also suggest that we should "leave it to LICIT," to design and implement a code of conduct for United States and third country investing corporations. If all corporations refused to accept performance requirements, and insisted on a regime of national and most-favored-nation treatment, then the obstacles to interventionist policies would be greatly increased. And if a joint labor and industry task force cannot work out a voluntary code, is there any reason to think that U.S. corporations would want Congressional restraints on their overseas behavior? Business has bridled under analogous prohibitions against paying bribes abroad or complying with foreign boycotts. Does U.S. business really want new legal limitations placed on its ability to accept foreign incentives or to submit to foreign performance requirements?

These are strong arguments for a policy of inaction. In the end, they may prevail. But there are two problems with leaving the problem to the market or to voluntary organizations such as LICIT. First, any solutions may be a long time in coming. In the meantime, many U.S. firms will lose foreign markets and the United States may be tempted to emulate the worst in foreign government policies. Second, any solutions reached by the voluntary approach will probably not address the negative effect of foreign performance requirements on U.S. firms and workers that are not a party to the negotiations with the foreign governments. To restate the point, it is unlikely that market disciplines or pressures from LICIT will redress the harm caused to those U.S. firms and workers who are indirectly affected by foreign interventionist policies. For these reasons, I am not attracted by a policy of inaction.

The remaining policy options can be grouped into three categories: multilateral, bilateral and unilateral measures. In my view, only unilateral measures will afford an effective response to the use of incentives and performance requirements abroad. Let me try to explain why.

MUTILATERAL EFFORTS

For some time now, U.S. policy has placed chief reliance on the advocacy of open multilateral investment relations. We have preached to the choir at the OECD, at Economic Summit meetings, in the GATT, and in the World Bank. Unfortunately, the choir only pretends to listen. Frankly, these efforts will only bear fruit if our negotiating partners are strongly motivated to limit the extent of their interventionist policies. Such motivation does not now exist.

From time to time, negotiating efforts have been centered on the elusive "GATT for Investment." But as long as the United States imposes no tangible costs upon its commercial partners that derogade from the principles of an open system, U.S. policy cannot succeed. No amount of eloquent appeals to the general well-being of the world commercial system will prevail. I suggest that solutions will occur only as a response to immediate pressure, not as a response to idealistic eloquence.

BILATERAL EFFORTS

As a second option, the United States could attempt to deal with these issues on a bilateral basis. The United States currently has Friendship, Commerce and Navigation treaties with a great many nations. The United States also has an extensive network of tax treaties. It would seem logical to bring these treaties (or their successors) to bear on the problems of investment incentives and performance requirements. However, existing FCN and tax treaties have little relevance for the new forms of interventionist investment policies, and it is not clear that our negotiators presently have the leverage to address these new problems by modifying the traditional treaties. The reason our negotiators have little leverage is that most host countries are not paricularly eager to negotiate

investment treaties in the first place. If the host country follows reasonably pragmatic pro-business policies (such as Singapore, Brazil or Kenya) it can generally attract a good deal of foreign investment without binding itself by a treaty. If the country does not follow pro-business policies, there is not much reason for it to negotiate a treaty giving special benefits to foreign firms.

Bilateral investment treaties are routinely concluded between West European nations and developing countries. Those treaties are designed to provide broad rights of establishment, national treatment, and most-favored-nation treatment for foreign investors. Often they include dispute settlement procedures to protect investments once made. But even those treaties do not address the performance requirement issue. Thus, even if the United States concludes a new network of investment treaties along the European model, performance requirements will very likely remain as a problem.

Many countries are anxious to negotiate an income tax treaty with the United States. Income tax treaties are desired by our treaty partners for three main reasons: they ensure a credit for taxes that might otherwise be pronounced not creditable under the U.S. Internal Revenue Code; they reduce withholding taxes; and they tidy up the boundaries of tax jurisdiction. Thus, the United States has a certain amount of leverage in negotiating tax treaties, leverage that might be used to promote our investment goals. But the U.S. Treasury officials who negotiate tax treaties seem oblivious to other dimensions of the investment process. Indeed, when I was in the Treasury, I found that my colleagues who negotiated tax treaties quite actively resisted suggestions that new tax treaties be linked to companion negotiations on investment issues. Such a linkage might profitably be explored by the Senate Foreign Relations Committee as it considers the 14 tax treaties now awaiting ratification.

However, I would not wish to exaggerate the amount of unused leverage inherent in tax treaty negotiations. At best, back-to-back negotiations between tax treaties and investment treaties might be used to obtain broad national treatment and rights of establishment clauses. It is unlikely that linked negotiations could seriously limit performance requirements.

The United States has attempted bilateral negotiations with Canada and Mexico to deal specifically with strained investment relations. The most prominent example was the set of negotiations in 1978–79 with Canada over the automotive industry. These negotiations failed to reach an accord, largely because there was no real inducement for Canada to modify its policies.

UNILATERAL MEASURES

The label of "unilateral measures" covers those actions that the United States may take, consistent with its international commitments,[2] designed to offset the effect of interventionist investment policies pursued by foreign nations. Well-designed unilateral measures will impose carefully scaled costs on host governments taking objectionable actions. If the costs imposed on host nations are sufficiently high, the practices will be limited, and foreign governments will become more willing to conclude bilateral or multilateral agreements. The art in designing unilateral measures is to fashion remedies that do not overreact, that redress the injury caused, that penalize the offender, and that minimize harm to innocent parties. The most difficult part of this prescription is to minimize harm to innocent parties. The U.S. escape clause, countervailing duty, antidumping duty and similar trade remedies invariably affect those who are not a party to the dispute. It is likely that remedies for performance requirements will also affect non-parties.

There are three forms of unilateral measures in terms of who holds the right of action: a purely public response, a mixed public-private response, and a purely private response. In my view, different responses are required for different dimensions of the investment intervention problem.

1. A public response

A public response would involve retaliation initiated by the U.S. Government. Such a response would lie within the discretion of the Executive, with no private party participation beyond the normal opportunity to petition the Government for relief.

[2] For a discussion of U.S. rights under the GATT against performance requirements, see an unpublished manuscript by Claude Fontheim, "Trade-Related Performance Requirements Under the GATT/MTN System and United States Domestic Law," June 1981.

One avenue available for a public response to the intervention policies of host governments is section 301 of the Trade Act of 1974. Under section 301, the President can respond to any act, policy, or practice of a foreign country that is inconsistent with the provisions of, or denies benefits to the United States, under any trade agreement, or that is unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. commerce. A proposed bill by Congressman Schulze, H.R. 4407, would clarify existing law to assure that the President can protect U.S. investment interests as well as U.S. trade interests.

The U.S. Trade Representative has initiated preliminary steps for a section 301 complaint against Canadian performance requirements imposed by the Foreign Investment Review Agency. The President has resurrected a proposed bill, rejected by the Congress during the Carter Administration, that provides "mirror" restrictions on the tax deductibility of U.S. advertisers on Canadian broadcasting media. These are steps in the right direction.

The armory of public responses at the disposition of the President should be suitably enlarged. This Subcommittee has authored amendments to OPIC legislation that would deny OPIC support to projects burdened with performance requirements in a manner that would reduce U.S. trade benefits. Similarly, Eximbank, Commodity Credit Corporation, and Foreign Military Sales support might be withheld from countries that encumber firms with certain types of performance requirements. Likewise, U.S. approval or disapproval of World Bank and regional development bank loans might be partly conditioned on the Country's adherence to an open trade and investment regime. Finally, new investment in the United States from countries that restrict national treatment or rights of entry might be restricted, as the Schulze bill provides, on a case-by-case basis.

But the answer does not lie simply in adding to Presidential thunderbolts. A purely public response under section 301 or auxiliary legislation will invariably have certain drawbacks. Firstly, the decision of the President and his officials in such cases will be heavily influenced by political factors. Almost invariably, the political factors will militate against taking firm action. Secondly, the private petitioner has little control over the proceedings after they are entrusted to the Executive branch. Indeed, the investigation may languish for long periods while inconclusive talks are held between the two governments. The third drawback, which follows the second, is that the remedy fashioned under a section 301 action or other public response legislation may not provide direct redress to the private party adversely affected by the foreign government's interventionist policies.

2. A mixed public-private response

A mixed public-private response could be patterned after the model of escape clause relief (Section 201 of the Trade Act of 1974). Under this model, the private petitioner would control the proceedings up to the determination of harm and the initial design of a remedy. The President, however, would determine what remedy (if any) would finally be granted (subject to Congressional override).

The right of action in a mixed public-private response should be limited to parties demonstrably affected by the performance requirement—notably, firms or workers actually making the product in question and losing sales as a result of the performance requirement. The eligible private party would petition for redress, perhaps to the International Trade Commission. If the International Trade Commission decided that relief was warranted, it would recommend an appropriate remedy, subject to Presidential review.

In order to implement the mixed response, section 301 could be amended to provide that the President must take action, within a set period of time, if a private party demonstrates harm to its interests. The U.S. Government, for example, might then bring a GATT case that an export performance requirement should be treated as the functional equivalent of an export subsidy (prohibited by Article 9 of the Subsidies/Countervailing Measures Code), or that a local sourcing requirement should be regarded as equivalent to import quotas (prohibited by Article XI of the GATT), and that to the extent these requirements hinder U.S. exports they involve a denial of national treatment (prohibited by Article III of the GATT).

To continue this example, unless the GATT issued a definitive ruling that the export or sourcing requirement was not a violation of the Code or the GATT, or unless the President made a determination in the national interest that relief was not appropriate, a countervailing measure would be imposed. The counter-

vailing measure could be directed against imports of the particular product. Alternatively, it could be directed against a much broader range of goods imported from the offending country, for the purpose of raising a fund to compensate the private party. Or, as a different approach, the International Trade Commission could recommend that OPIC, Eximbank, or similar programs be withdrawn by the President if negotiations did not produce satisfactory redress.

In my judgment, the mixed public-private response should be made available, with apprcpriate statutory deadlines, for virtually the whole range of performance requirements identified in testimony before this Subcommittee. Further, I think an explicit range of remedies should be enunciated in the statute (going beyond the trade remedies set forth in section 301) with an admonition that the ITC and the Executive should fashion a remedy that adequately compensates (but does not overcompensate) for the harm caused to the petitioner, and that, at the same time, offers the foreign country an incentive for productive negotiations.

Finally, since the best evidence of harm will often rest with the respondent, I suggest that the action be fashioned so that, once a case is made out by the petitioner that the foreign country is violating a GATT agreement or engaging in a defined unfair practice with a prima facie showing of harm to the petitioner, the burden of disproving the quantum of harm should shift to the respondent.

One result of more vigorous action along these lines is that the intervention process might be driven even deeper underground. In other words, performance requirements might be imposed by host nations on an ad hoc administrative basis, with details kept secret between the corporation and the host government. Indeed, host governments may attempt to thwart U.S. investigations by making it illegal for firms to disclose their discussions with the government. In the case of such blocking legislation, the U.S. law could shift the burden of disproving the petitioner's allegations to the respondent. Such a procedure would parallel the manner in which the antidumping and countervailing statutes now operate in cases where the foreign producer or government refuses to respond.

Some performance requirements—for example in the realm of local equity ownership or forced transfer of technology—are at the threshold of defined rules of "fair" and "unfair" practice. In these frontier areas, the Executive should retain considerable discretion (within the context of a mixed public-private response) as to the pace at which cases are brought and as to the remedies sought.

At the other extreme, some practices are in my view ripe for private action, along the lines of the countervailing duty and the private antitrust suit. I now turn to those practices.

3. A private right of action

Many U.S. business firms advocate legislation that would almost automatically impose various forms of reciprocity on foreign investors in the United States. Under such legislation, a "mirror" would be applied to the requirements that a host government imposes on U.S. investors; similar requirements would then be imposed, at the instigation of a U.S. petitioner, on firms from that country that invest in the United States. The proponents of this approach believe that it would catalyze the negotiation of bilateral investment treaties designed to eliminate performance barriers on a reciprocal basis.

Such legislation has appeared before in the Congress. For example, in 1980 Congressman Scheuer introduced H.R. 7791, amending the Securities Exchange Act of 1934 to impose a form of reciprocity on foreign direct investment flows between the United States and foreign countries on a case-by-case basis. The proposal was abandoned after hearings indicated that a U.S. policy of reciprocity might have unintended effects. For example, it might simply reinforce the policy of a foreign government that prefers to see the country's own investment capital remain at home.[3]

Proposals for reciprocity have surfaced again in response to Canadian energy policies. Bills are before the Congress to remove Canada from the reciprocity list under the 1920 Mineral Lands Leasing Act. The possibility that such policies will be directed against innocent parties is clearly underlined by the melding, in some minds, of Seagram's effort to take-over Conoco with the discriminatory Canadian National Energy Program (NEP). One had little to do with the other. Indeed, it is entirely pcssible that Seagram opposed the NEP.

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[3] U.S. Department of Commerce, International Trade Administration, "Summary of Foreign Investment Policies: A Survey of 35 Countries Inward Investment Policy and Outward Investment Policy," January 1981.

In my view, the time is not yet at hand to legislate a purely private right of action, with a reciprocity remedy or some other remedy, as an answer to investment restrictions that limit ownership levels or require the disclosure of technology. Until we have more experience with these restrictions, a mixed public-private right seems more appropriate.

On the other hand, in cases where a host government imposes export requirements, and the exports are shipped to the United States, a purely private right of action seems appropriate. A private remedy should be available whether the exports are shipped by a U.S.-controlled firm, a third-country-controlled firm, or a domestic firm. A U.S. manufacturer can already file a petition under the countervailing duty statute. However, in bringing the petition he faces three barriers: demonstrating injury, showing a bounty or grant, and establishing the amount of the subsidy. Congress could eliminate two of these barriers by defining a bounty or grant to presumptively include performance requirements, and by establishing a presumptive minimum subsidy. For example, a performance requirement might be presumed to be the equivalent of a 10-percent subsidy, unless the company subject to the requirement could demonstrate that any benefits received were worth a lesser amount.

A more difficult situation is posed by those instances in which performance requirements lead to export sales in third-countries. Even though those exports might diminish the export markets for competitive U.S. producers, no U.S. countervailing duty could be imposed on the foreign goods. In such a case, Congress could provide a remedy in terms of an award of money damages (carefully limited by statute as to presumed duration of lost sales and other dimensions), perhaps to be paid out of a low-rate tariff covering a wide range of goods shipped to the United States from the foreign nation. Again, the remedy should be available whatever the ownership of the firm that exports in conformance with performance requirements.

Similarly, a private right of action might be created against a host government requirement that production have a certain percentage of local content, or that a certain value of local sourcing be guaranteed. Again, money damages could be funded by a low rate tariff covering a wide range of goods.

In these cases, the Executive would simultaneously bring a GATT action under the Subsidies/Countervailing Measures Code, under GATT Article XXIII, or under some other GATT provisions, to ensure that GATT remedies were exhausted before the private remedy took effect.

CONCLUSION

In summary, I suggest that your Subcommittee study carefully tailored legislation that would enhance mixed public-private rights of action and create purely private rights of action to cope with carefully defined performance requirements. This legislation would give a very considerable push to stalled multilateral and bilateral talks, especially if the legislation provided that the rights of action would be suspended with respect to countries that negotiated appropriate standstills and phase-outs. Equally important, this legislation would provide carefully measured redress to parties harmed by interventionist policies.

In making this proposal, I am aware that many of our states provide ample investment incentives. I have not yet heard of a state conditioning its investment incentives on performance requirements, but it is entirely conceivable that some states do just that. Nor have I heard of federal performance requirements. But logical consistency requires that, if the United States complains about foreign performance requirements, foreign governments can also complain about any performance requirements imposed by our federal government or by our states. I realize that logical consistency is not always followed in trade matters, but I urge that it should be followed in this instance. Federal or state performance requirements found in violation of the GATT, the Codes, or other international obligations should be invalidated.

Mr. Chairman, that concludes my prepared remarks. I thank the Subcommittee for the opportunity to appear.

The CHAIRMAN. We thank you very much. Your testimony has a virtue which is all too rare these days, in that you have given us some very specific suggestions. Some of them are innovative, and they will be particularly helpful.

TAX TREATIES

Last week, we were examining in a hearing 10 tax treaties which have been submitted by the President for ratification by the Senate. Now, some of them are rather complex, and I don't claim that I have mastered all of them, but as far as I can recall, none of them touched the question of investment policy. The Treasury witnesses dealt with them as strictly relating to either forgoing or collecting revenues. They were not, at least in testimony, fitted into a kind of mosaic for strategic policy, assuming that we have a strategic policy.

What should we do with these treaties?

Mr. Hufbauer. Thank you for the opportunity to introduce a part of my testimony which I omitted in my oral remarks. When I was in the Treasury, it seemed to me that it would be appropriate to link tax treaties with simultaneous negotiations on investment treaties. As you know, Mr. Chairman, the investment treaty effort has been badly stalled. We haven't been able to negotiate treaties with either Singapore or Egypt to this day, and one would have thought if we could negotiate treaties anyplace it would have been with those two countries.

It seems to me that it is inappropriate to look at tax treaties simply as vehicles for sorting out tax boundaries, for firming up the foreign tax credit in cases where it would be possibly doubtful, or as a way of trimming down withholding taxes. Instead we should look at the whole investment relationship with the country in question.

For that reason, I would endorse suggestions on the part of the Congress to the executive branch that tax treaties should not be brought up in isolation. Instead there should be an attempt at companion negotiation of investment treaties that would deal with the wider issues. One even could go further, of course. One could suggest that Eximbank relations might very well be in part conditioned on a wider umbrella of relations in the investment area. But you are quite right: The executive branch so far has taken these issues piecemeal, and has not really developed a strategy.

The Chairman. Of course, you haven't told us whether we ought to reject the treaties on this ground or not. There may be other grounds for rejecting them.

Mr. Hufbauer. I know individual tax treaties have plenty of contentious issues and some of them may be rejected or at least held up on those issues. Perhaps it is late in the day for this generation of treaties to attach such a requirement of companion investment negotiations. But I certainly would hope that the next generation of treaties, including any of the treaties which are held over for other reasons, would be placed in the broader investment context.

The Chairman. Of course, it is an enormously important subject. Just to illustrate that point, within the past few years, the largest single private capital investment in the 350-year history of the State of Maryland has been made by a French investor. So, this is not a matter of casual interest. It is a matter of very significant interest in our own economic future.

I think it justifies the kind of treatment that you suggest we ought to give it. Let me ask you this. You have said that companies who are making international investments suffer from a certain ambivalence

as far as the United States is concerned. They do not like restrictions, but they also are afraid to speak up because they feel notwithstanding the first amendment that somehow or other free speech will cost them something.

LOSS OF PROPRIETARY INFORMATION

What are the ways to protect companies from the loss of proprietary information or from foreign retaliation while still being able to get the information that we want from them?

Mr. HUFBAUER. That is a good question. I do know that companies are very reluctant to discuss in detail the sorts of performance requirements for fear of just the sort of retaliation that you have indicated. It would seem to me that the Congress might be able, on a confidential basis, to elicit information from individual companies. Your subcommittee may very well want to go into executive session to receive testimony from selected firms that are known to be under these kinds of pressures.

The sort of mixed public-private rights of action that I have suggested would require some company to come forward. Some company would have to feel that the burden of these performance requirements and investment incentives was greater than the possible scope of retaliation. In the larger population of affected companies, there will be some who have tried bilateral negotiation and made other efforts, and at some point they may be willing to take recourse to stronger measures. But I doubt that one would find trade associations, or larger groupings of companies who would be willing to bring these cases up. Invariably there would be companies within those associations or groupings who still feel there is something to be gained by continued bilateral company to government talks.

So I would not expect a flood of actions, but I would expect some action on the part of highly frustrated individual companies.

That, of course, does point to the need for keeping alive the purely public response, such as the executive branch response under section 301 with respect to Canada. Very few companies today want to directly challenge the Canadian Government. They have too much at stake there. An exception was the border broadcasters, but that was because those companies had nothing positive left in their relations with Canada.

The CHAIRMAN. In the days when I was earning an honest living as a lawyer, I had a brother at the bar who used to say, God forbid that I should persuade you not to sue my client. There are certain advantages to going to court, if only for lawyers. But your testimony suggests a considerable reliance on litigation as an answer to this. I would wonder if perhaps you haven't relied too much on litigation as the vehicle for resolving these problems. My father used to say, the thin file with the release in it was the best case. [General laughter.]

Mr. HUFBAUER. Yes; there is a great deal of truth to that.

The CHAIRMAN. It is not always best for the lawyer, but usually is best for the client

Mr. HUFBAUER. Yes; and I don't want to add to the prosperity of the bar by the suggestions that I have made today. But it does seem to me that in the past we have seen cases that have had the virtue of spurring government solutions which might otherwise

have taken a very much longer time to occur. For example, the auto pact with Canada was inspired by a countervailing duty case. I believe the Moline firm, a parts manufacturer was the inspiration for the pact.

As you know, the threat of countervailing duty actions was the inspiration for the Subsidies Code negotiated in the multilateral trade negotiations. Recently a countervailing duty action against India has prompted, as I understand it, a negotiated agreement between the United States and India on Indian accession to the Subsidies Code.

I think other examples can be found where private action has stimulated Government negotiation much faster than it otherwise would have taken place.

I do not entirely dismiss the simple option of mulitlateral negotiations or bilateral negotiations, but we have been working on those particular vineyards for quite some time now, with very little success relative to the effort put in. That does lead to thoughts of alternative solutions which possibly might have some success.

I would like to conclude that I am very mindful of your concerns, and I certainly would not want to turn this area into anything remotely approaching the private treble damage antitrust action.

DIFFERENT ATTITUDE TOWARD FOREIGN RESTRICTIONS OR FOREIGN SUBSIDIES

The CHAIRMAN. Should we have a different attitude toward foreign restrictions or foreign subsidies for U.S. direct investment between a developed country and a developing country?

Mr. HUFBAUER. In other words, should we be somewhat more tolerant of the restrictions imposed by developing countries?

The CHAIRMAN. Yes; and this leads us back to our concept of what is our strategic objective? Do we have a strategic objective? If you believe there is going to be a 50-percent increase in world population or even a 25-percent increase, let's cut that in half and be very conservative, a 25-percent increase in world population in the next 20 years, and that 90 percent of that is going to occur in developing countries, do we have such an interest in promoting stability in those countries that this ought to be part of our national plan, whereas such a consideration would not apply with respect to France or the Federal Republic of Germany or Great Britain?

Mr. HUFBAUER. Well, we have a great stake, obviously, in both areas. As you noted, some highly developed countries, of which I suppose Canada is the prime example, have been as active in these policy vineyards as developing countries. In principle I see no reason to distinguish between the two groups of countries. I think our policy ought to be consistent throughout. In practice, I believe it would be easier to negotiate the preservation of an open regime with many of the developed countries because they have departed less far from that regime today. But I think without action they could depart a great deal further in another 5 years. I think our policy effort ought to emphasize standstill and phase-out approaches. For example, there are many developing countries which, fortunately, have not yet adopted these interventionist polices. I don't think we should take

the view toward those countries that "You can go to the level of intervention represented by the Mexican Auto Decree."

The CHAIRMAN. Sort of a most favored nation concept?

Mr. HUFBAUER. Right. I don't think it is desirable. Mexico now is going to expand the auto decree, I think, to drugs, pharmaceuticals, electronics, and computers. Mexico probably will do that well before any action by the U.S. Government takes place.

I think it would be most unwise to allow the Mexican standard, for example, to apply to every other developing country. What we really want is a freeze on this sort of behavior at the earliest opportunity.

PERFORMANCE REQUIREMENTS

The CHAIRMAN. You have commented at some length about performance requirements. Do you think they actually help development in developing countries?

Mr. HUFBAUER. No; I don't. I think they are against the basic interests of the developing countries, because I think they lead to quite costly distortions. But performance requirements often represent a bureaucratic triumph. They have the illusion of seeming, by bureaucratic intervention, to achieve goals which otherwise would not have been achieved. The injury and harm they cause is not easily perceived, whereas the number of employees, the value added, the exports are perceived. So there is a great deal of illusory economics going on which can keep these policies going for many years.

That reminds me of the period of the 1950's and 1960's when import substitution was the rage in many developing countries. All sorts of restraints were put up in the name of import substitution. Eventually, a natural reaction did set in, but the economic harm done by those regimes went very, very far indeed, before there was a reaction in countries like Brazil and Chile in the world against that approach.

The CHAIRMAN. Some time ago Prime Minister Trudeau came to Washington and met privately with a group of us to discuss the Canadian energy policy. He justified it on the grounds that it was Canada's plan to avoid becoming an oil-deficit nation. They had made an estimate of their energy reserves and were going to ration them out over a number of years.

UNDERSTANDING REAL OR FUTURE PROBLEMS OF CANADIANS

He acknowledged that that created some problems as far as the United States was concerned because of our inability to continue to import the volumes that we had been importing from Canada. We have some similar problems with Canadian investment policy. Should we react to these by passing some of the bills that are now pending in the Congress, to place a moratorium on Canadian takeover of U.S. firms as a kind of retaliation, or should we be more understanding of either the real or the future problems of Canadians?

Mr. HUFBAUER. In the summer, a colleague of mine and I wrote a long piece for the Atlantic Council on Canadian-U.S. investment relations. I will do a little bit of advertising for that piece, which is forthcoming. It attempts to review the range of disagreement that we have with Canada on the investment regime. Those disagreements are broad, deep, and long-standing.

My concern with many of the retaliatory bills now in Congress is twofold. First, that they would in a sense provide political support to exactly the direction which Trudeau is embarked upon. Those bills would be seen as evidence of a bullying attitude by the United States. Moreover, Trudeau might prefer that we erect barriers to prevent Canadian companies from coming to the United States so that he can better pursue a nationalistic policy of keeping Canadian companies at home. So, I cannot see that the bills are, on the whole, helpful in a political sense.

In addition, many of the bills would penalize entirely innocent parties. The Seagrams case got a great deal of attention. I don't know what goes on in the executive suites of Seagrams, but there is no indication that I saw that Seagrams was a fan of the national energy policy of Canada. Seagrams wanted to buy Conoco, and in the end, they didn't succeed, but I cannot see the rationale for having limited the Seagrams takeover bid as retaliation for the national energy policy.

Indeed, part of the market solution, if you will, to Canadian distortions is to allow Canadian firms to come to the United States. Perhaps in the fullness of time, the present Canadian Government, or a successor government, will see the lack of wisdom in the policies now being pursued because of their depressing climate on overall Canadian investment.

That is rather long-winded, Mr. Chairman, but I will conclude by noting there is a great deal of internal opposition with Canada to the sort of policy line upon which Trudeau has embarked. Internal opposition is really our best hope for a shift away from this policy line.

The CHAIRMAN. We are very grateful to you, Dr. Hufbauer, for being here. I hope you will have an opportunity to remain for some of the rest of our hearing. We are going to keep the record open for a reasonable time so that if you want to react further, we will be glad to have any further comment that you would care to make on this subject.

Mr. HUFBAUER. Thank you very much, Mr. Chairman.

The CHAIRMAN. Our next witness is Mr. Joseph E. Connor, the distinguished chairman of Price Waterhouse and Co.

Mr. Connor, it is a great pleasure to have you here this morning.

Mr. Connor, I want to afford you the same opportunity that I gave to Dr. Hufbauer to summarize your testimony. Your statement will appear in full in the record.

STATEMENT OF JOSEPH E. CONNOR, CHAIRMAN, PRICE WATERHOUSE & CO., NEW YORK, N.Y.

Mr. CONNOR. Thank you very much, Mr. Chairman.

For the record, I am Joseph E. Connor, chairman and senior partner in the U.S. accounting firm of Price Waterhouse. I welcome the opportunity to testify before your subcommittee.

The basis of that testimony is the 73-nation study concerning restrictions on foreign investment. This study was based on information developed by Price Waterhouse offices located in the selected countries. With respect to each country, the data is limited to nontax investment policies regarding ownership restrictions, exchange controls,

repatriation or remittance restrictions, employment restrictions, and local material content requirements.

Also included is information concerning subsidies and other incentives to foreign investment.

Senator, we undertook our study for two principal reasons: First, to call attention to the need for greater emphasis to be devoted to international investment policy. Generally, our policymakers have placed a disproportionate emphasis on trade issues to the exclusion of investment issues. As important as they are, trade issues must not dominate policymaking. Investment issues are, in our view, equally important. They need attention, and they must have it before a crisis develops.

The second reason for undertaking the Price Waterhouse study was to develop a base of information to assist our policymakers in implementing an effective international investment policy. Present U.S. policy toward international direct investment, as articulated by the State Department in 1977, is, "to neither promote nor discourage inward or outward flows of activities. * * * This policy is consistent with our longstanding commitment to an open international economic system."

Our firm has no quarrel with this commitment, but we believe strongly that the competitive world economic climate of the early 1980's calls for a reshaping of the practices which underlie it. Specifically, we urge adoption of an aggressive program to promote, to encourage, and to facilitate U.S. direct investment abroad, supported by clear reaffirmation of U.S. neutrality toward inward investment.

Let me explain why we favor such a policy, and how we believe it best would be implemented. First, let me discuss U.S. direct investment, the benefits as we see them. How does U.S. overseas investment benefit efforts to better our global competitive position? In the most direct way possible, by increasing U.S. exports. Trade and investment flows are closely related. An influx of investment capital from the United States creates new jobs, new markets, and new technology, enhancing both the demand for imports from the United States and the ability to finance them.

Establishing local subsidiaries to promote and distribute goods, a common and effective way of overcoming trade barriers to identical goods produced in the United States, has a variety of good results. The most obvious benefit is to penetrate export markets with American products manufactured abroad, markets that would otherwise be lost to foreign competitors. Less obvious but also important benefits are creating secure long-term demand for American equipment, materials, and services needed to expand, modernize, and maintain foreign production facilities, and opening new markets for American made imports to be sold and serviced through the foreign affiliate's established channels.

These thoughts are not hypotheses, theories, or conjectures. They are based on solid empirical data, including a 1981 study entitled "U.S. Investment Abroad," also made by my firm in cooperation with the U.S. Council of State Chambers of Commerce.

We submitted a copy of this study to your last subcommittee during the time of your hearings last July. In our view, the evidence that U.S. foreign investment directly and substantially benefits the Ameri-

can economy is not only persuasive, but overwhelming. And equally important, so is the evidence that U.S. foreign investment simply does not give rise to the variety of economic ills often attributed to it: Loss of export markets to U.S. foreign affiliates selling abroad; loss of domestic markets to U.S. foreign affiliates competing here; or creation of domestic unemployment which is the "job export" syndrome.

Nevertheless, these myths persist. It is high time to recognize them as such and to dispel them. Bear in mind also that direct foreign investment can accelerate the modernization and economic growth of the world's underdeveloped countries. Quite apart from the considerable diplomatic and humanistic benefits, there is a practical business benefit as well, a reduction in the need for and reliance on U.S. foreign aid.

Every dollar of new direct U.S. investment in a developing country tends to supplant a dollar of U.S. foreign aid, and as the investment dollars accomplish their objectives of creating local industrial and commercial capability, the long-run expectation is emergence of a new, self-sufficient U.S. trading partner.

In brief, everybody wins.

The essential concomitant to a national policy of encouraging foreign direct investment is an open international economic system, ostensibly U.S. policy since 1977, as I noted earlier, but quite ineffectively implemented. The regrettable fact is that barriers to foreign investment exist in many countries today, with new ones being erected continually. Some consist of laws and regulations supposedly applying across the board, but which in practice discriminate against foreign-owned business.

A review of our country-by-country analysis supports this conclusion.

Price Waterhouse urges the administration to reaffirm the traditional U.S. posture of neutrality toward investment flows and to pursue that policy at home and abroad. An overriding American objective should be equitable national treatment for all investors in all countries. The goal should be to build bridges rather than walls.

An essential first step is to demonstrate convincingly our own neutrality toward inward investment from abroad: our own commitment to evenhanded national treatment of all business within our borders. The selling of America is an oft-voiced concern of some citizens and lawmakers today. As an emotional concern, it is understandable, but shortsighted. Certainly it is tempting to restrict inward investment, and in limited instances it may be necessary, but can the United States really expect equitable treatment of American business abroad if we ourselves deny it to foreign business here?

FOREIGN INVESTMENT IN THE UNITED STATES

The Chairman. Let me interrupt you at this point, Mr. Connor, with a question that is pertinent. Do you feel that foreign investment in the United States has reached any dangerous level?

Mr. Connor. Well, there is a change in the trend, Senator. Historically, as an auditor looking at a balance sheet, there are $3 of American investment abroad today for every $1 in this country, but that ratio is not the picture in the last couple of years, where foreign investment is greater in this country than U.S. investment is abroad. The balance is moving in the other direction.

The CHAIRMAN. Is that the yearly trend, or is that the cumulative total?

Mr. CONNOR. The 3 to 1 is a cumulative total. The yearly trend balances in favor of foreign investment in the United States.

The CHAIRMAN. But it hasn't changed the total?

Mr. CONNOR. No; but give it time.

The CHAIRMAN. Give it time, you say?

Mr. CONNOR. I think that is a fair reading of what is happening now. For example, in looking at trends, investment trends in this country, there are some 55 German companies investing in the area of the Carolinas and as far north as your State and as far south, obviously, as Georgia. That is the decided geographical area of particular interest to German investment activity. That is not bad, now. I am saying that it is a decidedly different picture than what we have ever seen before, and it will reverse in time the trend that we have lived with for a long number of years, since the end of the Second World War.

The CHAIRMAN. But let me repeat my question. Do you see it as a dangerous trend?

Mr. CONNOR. I believe that there should be free movement, and I am worried that the current movement is not in the United States favor.

The CHAIRMAN. Thank you. Please continue. Excuse my interruption.

Mr. CONNOR. Let me turn back to achieving national treatment. U.S. Government support of private sector efforts to combat foreign host country discrimination does not even remotely imply some Government control of business or some form of Government-investor partnership. It implies exactly what it says, that our Government should work actively to achieve national treatment for our business enterprises operating abroad, a complete departure from its aloof, hands-off posture of recent years.

We certainly endorse U.S. participation in multilateral efforts to promote the flow of international investment, for example, those of the OECD, but we believe that one-on-one bilateral negotiations with host governments offer more promise of substantial near-term results with negotiation zeroing in on the specifics of the real world walls actually encountered by would-be U.S. investors.

Let me turn next to tax treaties, a question that you posed a few minutes ago. The United States now has tax treaties with some 49 nations, but not with most of the developing countries, including some attractive investment locations, and many of the treaties already negotiated fail to address adequately some significant tax disincentives to U.S. investment in the respective countries.

Turning to investment treaties, in many cases the nontax obstacles encountered by potential U.S. investors are considerably more formidable than the tax barriers. As described more fully in the Price Waterhouse study, such restrictions generally include very complex application processes, unrealistic future performance requirements, restrictions on importation of essential materials, on foreign equity participation, on repatriation of capital or profits, on expatriate employees, and limited access to local credit.

While some developed countries have erected these nontax walls to investment, they are generally more characteristic of developing nations with tightly controlled economies.

American businesses seeking to invest in these countries are at a disadvantage without U.S. Government assistance, and a bilateral investment treaty may be the best means of intervening effectively. Many, even most developing countries simply do not have the capital necessary for the economic growth that is the key to infrastructure, employment, social betterment. That capital can be formed only through foreign investment.

Understandably, developing countries insist that inward investment must in fact further legitimate national goals and aspirations. Also understandably, foreign investors insist on assurances of a stable business environment conducive to profitable operation. Together, these demands constitute an ideal scenario for government-to-government negotiation of investment treaties beneficial to both sides.

We hope our 73-nation study of investment policies will assist our policymakers in forming an aggressive program to promote, to encourage, to facilitate United States direct investment abroad. Moreover, we urge that the investment treaty approach under development by the Office of the U.S. Trade Representative be pursued with as many countries as practical. We consider it essential that the U.S. Government hold to its new-found international perspective in shaping new trade and investment policy. The United States must not waiver from its traditional posture of openness and neutrality toward international commerce, and it must aggressively encourage other nations to take the same posture.

We must remain sensitive, responsive to the international dimension of capital formation, the unfettered flow of investment. Shortsightedness, economic isolationism, and failure to recognize the inseparability of political and economic policy simply must not be allowed to shackle the revitalization of our country via the renewal of our traditional competitive edge in global markets.

Thank you, sir.

[Mr. Connor's prepared statement follows:]

Prepared Statement of Joseph E. Connor

I am Joseph E. Connor, Chairman and Senior Partner of the United States public accounting firm of Price Waterhouse. I am privileged to have the opportunity to testify before your Subcommittee on our 73-nation study concerning restrictions on foreign investment.

My statement is based on information developed by Price Waterhouse offices located in the selected countries. With respect to each country, the data is limited to non-tax investment policies regarding ownership restrictions, exchange controls, repatriation or remittance restrictions, employment restrictions and local material content requirements. Also included is information concerning subsidies and other incentives to foreign investment.

We undertook our study for two principal reasons. First, to call attention to the need for greater emphasis to be devoted to international investment policy. Generally, our policymakers have placed a disproportionate emphasis on trade issues to the exclusion of investment issues. As important as they are, trade issues must not dominate policymaking. Investment issues are, in our view, equally important. They need attention and they must have it—before a crisis develops.

Our second reason for undertaking the study was to develop a base of information to assist our policymakers in the implementation of an effective international investment policy.

Present United States policy toward international direct investment, as articulated by the State Department in 1977, is ". . . to neither promote nor discourage inward or outward flows or activities. . . . This policy is consistent with our longstanding commitment to an open international economic system." Price Waterhouse has no quarrel with this commitment, but we believe strongly that the competitive world economic climate of the early 1980's calls for a reshaping of the practices which underly it.

Specifically, we urge adoption of an aggressive program to promote, to encourage, and to facilitate U.S. direct investment abroad, supported by clear reaffirmation of U.S. neutrality toward inward investment.

Let me explain why we favor such a policy, and how we believe it would best be implemented.

U.S. DIRECT INVESTMENT: THE BENEFITS

How does U.S. overseas investment benefit efforts to better our global competitive position? In the most direct way possible: by increasing U.S. exports.

Trade and investment flows are closely related: an influx of investment capital from the U.S. creates new jobs, new markets, and new technology—enhancing both the demand for imports from the United States and the ability to finance them.

Establishing local subsidiaries to produce and distribute goods—a common and effective way of overcoming trade barriers to identical goods produced in the United States—has a variety of good results. The most obvious benefit is to penetrate export markets with American products manufactured abroad—markets that would otherwise be lost to foreign competitors. Less obvious, but also important, benefits are:

Creating secure, long-term demand for American equipment, materials, and services needed to expand, modernize, and maintain foreign production facilities.

Opening new markets for American-made imports to be sold and serviced through the foreign affiliate's established channels.

These thoughts are not hypotheses, theories, or conjectures. They are based on solid empirical data, including a 1981 study entitled U.S. Investment Abroad made by Price Waterhouse in cooperation with the U.S. Council of State Chambers of Commerce. We submitted a copy of this study to your Subcommittee during the time of your hearings last July. In our view, the evidence that U.S. foreign investment directly and substantially benefits the American economy is not only persuasive but overwhelming.

And, equally important, so is the evidence that U.S. foreign investment simply does not give rise to the variety of economic ills often attributed to it: loss of export markets to U.S. foreign affiliates selling abroad; loss of domestic markets to U.S. foreign affiliates competing here; or creation of domestic unemployment (the "job-export" syndrome). Nevertheless, these myths persist. It is high time to recognize them as such and to dispel them.

Bear in mind also that direct foreign investment can accelerate the modernization and economic growth of the world's underdeveloped countries. Quite apart from the considerable diplomatic and humanistic benefits, there is a practical business benefit as well: a reduction in the need for and reliance on U.S. foreign aid.

Every dollar of new direct U.S. investment in a developing country tends to supplant a dollar of U.S. foreign aid. And as the investment dollars accomplish their objectives of creation local industrial and commercial capability, the long-run expectation is emergence of a new, self-sufficient U.S. trading partner. In brief, everybody wins.

BRIDGES RATHER THAN WALLS

The essential concomitant to a national policy of encouraging foreign direct investment is an open international economic system—ostensibly U.S. policy since 1977, as noted earlier, but ineffectively implemented.

The regrettable fact is that barriers to foreign investment exist in many countries today—with new ones being erected continually. Some consist of laws and regulations supposedly applying across the board but which in practice discriminated against foreign-owned business. A review of our country-by-country analysis supports this conclusion.

Price Waterhouse urges the Administration to reaffirm the traditional U.S. posture of neutrality toward investment flows and to pursue that policy at home and abroad. An overriding American objective should be equitable national treatment for all investors in all countries. The goal should be to build bridges rather than walls.

An essential first step is to demonstrate convincingly our own neutrality toward inward investments from abroad; our own commitment to even-handed national treatment of all business within our borders. "The selling of America" is an oft-voiced concern, it is understandable but short-sighted. Certainly it is tempting to restrict inward investment, and in limited instances it may be necessary, but can the United States really expect equitable treatment of American business abroad if we ourselves deny it to foreign business here?

On the other hand, the neutrality we advocate is by no means a unilateral concept. Reaffirming our neutrality toward inward investment is not enough: our government must firmly reject the unconstructive, do-nothing attitude of recent years toward U.S. investments abroad in favor of all-out, sustained pursuit of such investments. To be tough business competitors, American multinationals must be supported by a government that will be just as tough in ensuring that we get the same national treatment abroad that we give here. We should take the lead in building those trade and investment bridges—but we should insist that other demolish their walls.

ACHIEVING NATIONAL TREATMENT

U.S. Government support of private-sector efforts to combat foreign host-country discrimination does not even remotely imply more government control of business, or some form of government-investor partnership. It implies exactly what it says: that our government should work actively to achieve national treatment for our business enterprises operating abroad—a complete departure from its aloof, hands-off posture of recent years.

We certainly endorse U.S. participation in multilateral efforts to promote the flow of international investment, for example, those of the Organization for Economic Cooperation and Development concerning a declaration on national treatment. But, we believe that one-on-one bilateral negotiations with host governments offer more promise of substantial, near-term results, with negotiations zeroing in on the specifics of real-world walls actually encountered by would-be U.S. investors.

Tax treaties

One of the most powerful tools of bilateral negotiation is the tax treaty. The United States now has tax treaties with some 49 nations—but not with most of the developing countries (including some attractive investment locations). And many of the treaties already negotiated fail to address adequately (or even at all) some significant tax disincentives to U.S. investment in the respective countries.

Investment treaties

In many cases, the non-tax obstacles encountered by potential U.S. investors are considerably more formidable than the tax barriers. As described more fully in our study, such restrictions generally include: labyrinthine application processes; unrealistic future performance requirements; restrictions on importation of essential materials, on foreign equity participation, on repatriation of capital or profits, on expatriate employees; and limited access to local credit.

While some developed countries have erected these non-tax walls to investment, they are generally more characteristic of developing nations with tightly controlled economies. American businesses seeking to invest in these countries are at a disadvantage without U.S. Government assistance, and the bilateral investment treaty may be the best means of intervening effectively.

Many, even most, developing countries simply do not have the capital necessary for the economic growth that is the key to infrastructure, employment, and social betterment. That capital can be formed only through foreign investment. Understandably, developing countries insist that inward investment must in fact further legitimate national goals and aspirations; also understandably, foreign investors insist on assurances of a stable business environment conducive to profitable operations. Together these demands constitute an ideal scenario for government-to-government negotiation of investment treaties beneficial to both sides.

We hope our 73-nation study of investment policies will assist our policymakers in forming an aggressive program to promote, to encourage, and to facilitate U.S. direct investment abroad. Moreover, we urge that the investment treaty approach under development by the Office of the U.S. Trade Representative be pursued with as many countries as practicable.

A final word.

We consider it essential that the U.S. Government hold to its new-found international perspective in shaping new trade and investment policies. The United States must not waiver from its traditional posture of openness and neutrality toward international commerce—and it must aggressively encourage other nations to take the same posture.

America must remain sensitive and responsive to the international dimension of capital formation: the unfettered flow of investment. Shortsightedness, economic isolationism. and failure to recognize the inseparability of political and economic policy simply must not be allowed to shackle the revitalization of our country via the renewal of our traditional competitive edge in global markets.

The CHAIRMAN. I thank you, and I certainly agree with your statement that we must remain sensitive and responsive to the international dimension of capital formation, the unfettered flow of investment. Without that, we really cannot claim in any comprehensive sense to be a free enterprise economy or a free enterprise society.

FLOW OF INVESTMENT

Let me refer for just a minute to our previous conversation on the subject of the flow of investment, the reversal of the trend from a predominance of American investment abroad to a predominance of foreign investment here. How much of that is due to the recent rise in interest rates in this country, and to the activity of the stock market?

Mr. CONNOR. Are you talking here about passive or active investment? Obviously, the interest situation in the United States is attracting foreign passive investment. I think that is part of the competitive environment. I was more talking to situations of commercial investment, and where I think the investment analysis is a little different.

The CHAIRMAN. In other words, your answer would be, so far as commercial investment is concerned, high interest rates have not played a significant part?

Mr. CONNOR. In my experience, you decide where you want to invest, and then you decide where you can get the money cheapest to make that investment. They may not necessarily be in the same place.

The CHAIRMAN. I think we are all in your debt for the comprehensive survey of investment policies in 73 countries.

Mr. CONNOR. Thank you.

The CHAIRMAN. It seems to me that will be an enormously useful study, and one that I suspect cost your firm a considerable investment of both time and resources. We will review that study and your findings very carefully. I suspect it will become a kind of benchmark for us, and I would hope for our friends downtown at Treasury to review and from which to take action.

In the light of that very large public contribution that I think you have made, I would be reluctant to suggest that you should do anything further, but since you have done the initial work, it seems reasonable that you would be the most efficient and effective firm

to track developments in this area, to see where the 73 countries go from here. I would hope you might consider doing that.

Mr. CONNOR. I think we would. Your question to the preceding witness is applicable. We have concerns. Obviously, our study is based on real live experience. It was written not by Americans. It was written by nationals of the 73 countries which are included in the study, and where my partners practice. They are aware of those circumstances where difficult, invisible investment barriers have been erected. I believe that there is an opportunity for the subcommittee to consider aggregation of individual company experiences in those countries amassed by an outside party that would aggregate them. If you have a real interest in, as I believe you do from your previous question, what has been individual companies' experience, that might be a way to get at it, without the retaliatory concerns that an individual company standing by itself might legitimately have.

TAX TREATY AS A MECHANISM

The CHAIRMAN. Let me ask you essentially what I asked Dr. Hufbauer. In your opinion, should we use the tax treaty as a mechanism in which to help forge investment policy?

Mr. CONNOR. I think it is too late, with almost 50 of them now in operation. No. 51 looks a little bit at that as, why me? As for the concept, the tax treaties were developed as a method of fairness between countries, that only one country would tax income of a certain source. Basically, it was to be a neutral document. We are asking for the same thing, in effect, on investment treaties; whether they are cojoined or separate seems to me to be not the whole issue.

We also believe that there may well be a role for other parts of the executive structure of government in negotiating investment treaties. We have been critical of the hands-off attitude of the State Department, for example.

The CHAIRMAN. Again, I have to say, as I said before, that you assume we do have an investment policy, or one has to assume it in order to hope—

Mr. CONNOR. But I think we do, Senator. I think we have an investment policy which is neutrality, in the sense of neither promoting nor discouraging. Right now, we are neutral to investment coming into the United States, in that there is no discrimination of which I am aware. What I am saying is, the balance must be put right through an aggressive posture of achieving that same neutrality to outer flows of U.S. investment. So, I think we do have policy. It may not be effectively implemented on the other side, however.

The CHAIRMAN. I think perhaps we have a kind of empiric policy. I am not sure how well it is understood in a conscious and deliberate way by a good many people who are responsible for executing various phases of it.

Mr. Connor. I would agree with that.

The CHAIRMAN. So perhaps it ought to be enunciated. Maybe that is what I am getting at, that we need to enunciate our investment policy.

Mr. CONNOR. I think the best enunciation might well be an aggressive, hands-on supportive State Department role in negotiating investment treaties, rather than hands off.

BUILDING BRIDGES

The CHAIRMAN. Yes, I agree.

You referred in your testimony to building bridges. I think most people would agree with that, but it was suggested in the earlier hearings in July that before you could build bridges you might have to build walls. A kind of bargaining chip concept. How does that appeal to you?

Mr. CONNOR. I think there is always a bargaining process that goes on. It is well, for example, to say that we should have a uniform investment posture relative to developed versus developing countries, but I think that is not practical at this particular point.

The other side has different chips that it wants to exchange. Some of them are short term and some of them long term in the case of developing countries. I believe that this has to be a factor. That I think is the reason, although I don't remember the exact quote to which you are referring, for the thought behind it, which is that we have to negotiate hard on investment treaties just like we negotiate hard on tax treaties.

DISTINCTION BETWEEN SUBSIDIES OR PERFORMANCE REQUIREMENTS

The CHAIRMAN. Would you see any proper distinction between the subsidies or the performance requirements of developing countries and those of developed countries?

Mr. CONNOR. I think there is more sensitivity on the other side, in developing countries. I think that is part of the bargaining process, of the tradeoff. I think also developing countries perhaps have less appreciation. It has taken a long time. I think really the hearings in July went a long way to promote that, that everybody in fact does benefit from foreign investment, from anybody's foreign investment anywhere. Jobs are created in both the exporting and importing country. But it takes a little time to get that message across.

The CHAIRMAN. What is your opinion about the value of performance requirements in developing countries?

Mr. CONNOR. They are more emotional than real. I would agree with the preceding witness. For example, some of the defense offset agreements, well, it may be in my own backyard, but our firm, for example, consults extensively with foreign defense contractors over compliance with U.S. cost-accounting standards. While that is understandable and necessary under the acts, it is a complication.

The CHAIRMAN. What about the Canadian situation, and the flurry of legislation that has been offered here to retaliate against——

Mr. CONNOR. I think that is the wrong approach. My view is that the Canadians should open their borders just as ours now are open. I believe that is the answer, not to close our borders in retaliation against the partial closure of theirs.

American investment in Canada for a long number of years has promoted the economic improvement of that country. That is fact. American oil companies have developed Canadian oil reserves. That is fact. And Canadians have prospered as a result. Where is the bad side of that? I think the Canadians must ask themselves that question. I think it is perfectly appropriate in an aggressive investment mode for

the United States to point out the benefits of Canada which that historic policy has achieved for them, and to encourage them to maintain that, rather than for us to take a restrictive investment policy, the "now we'll show you" type attitude.

Let's help them learn, rather than the other way around.

The CHAIRMAN. Once again, we are very grateful to you for the extensive study that you have made, and for your presence here today and your testimony. I hope as we walk down this road we can look forward to your continuing advice and counsel.

Mr. CONNOR. Thank you, Senator.

The CHAIRMAN. We thank you.

Our next witness is Mr. Richard W. Roberts, president of the National Foreign Trade Council, Inc.

Mr. Roberts, I will remind you that we will include your full statement as a part of our record, so you may wish to summarize it.

STATEMENT OF RICHARD W. ROBERTS, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC., NEW YORK, N.Y.

Mr. ROBERTS. Thank you, Mr. Chairman.

I will summarize it briefly, in about 11 minutes.

My name is Richard Roberts. I am president of the National Foreign Trade Council. I appreciate this opportunity to discuss U.S. investment policy, which is the subject of the committee's inquiry.

The specific question I will address is, what are some actions which should be taken by our Government to support U.S. private direct investment abroad. Such investment, with a book value of $213 billion, makes an important contribution to the Nation's economic health by expanding the market for U.S. goods and services and providing a substantial inflow to the U.S. balance of payments, about $38 billion in 1979. Private direct investment overseas also serves broad national interests by strengthening the economies of free world nations.

We believe the primary responsibility for attracting and retaining investment funds from the United States or other sources rests with host countries. If a foreign nation wishes to attract capital from abroad for economic development, it must provide a hospitable investment climate. Such practices as expropriation of foreign investment, coerced sale of assets, confiscatory taxation, coerced contract concession, renegotiation, or other acts of discrimination against investments of foreign nationals all poison the investment climate. Countries which engage in these practices or fail to provide a secure and stable investment climate through clear and consistent investment-related laws and policies cannot expect private investors from abroad to make significant investment commitments. Such countries are likely to become increasingly dependent on official aid.

Before making major aid commitments to individual countries, the United States and the multilateral development loan institutions in which the United States participates should consider the extent to which the applicant's investment policies may have foreclosed development by private capital.

While the primary responsibility for attracting capital rests with host countries, there are a number of actions which the United

States can take to promote the free flow of international capital and protect and support U.S. investments abroad.

First, when U.S. private investment abroad is threatened with action which is not in accord with international law or applicable international agreements, U.S. Government should take appropriate measures to discourage such action, and should insist that foreign governments observe undertakings freely entered into.

In this connection, we welcome recent statements by the Department of State that it is the responsibility of our Government to provide full support for American investors whose investment interests are threatened by violations of international law and agreements.

Because there are varying degrees of recognition of the applicable international legal principles, and in order to establish agreed ground rules to deal with such critical investment issues as expropriation and national treatment, we strongly recommend that the United States vigorously pursue a program of negotiating bilateral investment protection treaties with developing countries.

To date, we have been, in candor, most disappointed with the progress of the United States in embarking on a treaty program. In the past 5 years, no treaty has been signed. By contrast, West Germany has entered into about 50 such treaties, and the total number of treaties entered into by all countries, including such major trade competitors as Japan, France, Germany, and the United Kingdom, exceeds 175.

If the U.S. program is to move forward, more resources must be devoted to it. Private investment in developing countries such as those of the Caribbean area, which the United States views as in the national interest, will be accelerated if a network of bilateral investment treaties is speedily developed.

Second, the United States should use its position of world economic leadership in an international effort against the proliferation of performance requirements and investment incentives. By and large, both industrial nations and developing nations in the long run are hurt by performance requirements which, like trade restrictions in general, create economic inefficiencies which can only rarely be justified.

Because some U.S. businesses have been forced to adapt to performance requirements in host countries, it would be appropriate for the United States to urge a gradual dismantling process in order to provide time for transition to a freer environment.

Now, how should the United States proceed to develop an international consensus on measures to resolve the problem? We think it better to hold discussions within the framework of an existing international institution such as the GATT or the OECD rather than to create a new apparatus. An advantage of working through GATT is that its members include many developing countries.

Some types of performance requirements, such as minimum export quotas, may already violate the GATT codes, but most are beyond its reach, as are investment incentives, such as tax concessions.

Our suggestion is that the GATT be amended to cover more explicitly trade-related performance requirements, and that restrictions on investment-related performance requirements and invest-

ment incentives be added. We do not wish to be understood as advocating amendments which would set forth detailed rules for investors in host countries respecting foreign direct investment.

A proposal to create a GATT for investment might well evolve at the insistence of the group of 77 and their adherents into a counterproductive negotiation of an investment code for multinational companies, including provisions to further the so-called new international economic order which involves extensive governmental intervention in investment flows.

We favor a cautious U.S. initiative, limited to dealing with harmful performance requirements and investment incentives.

Our third recommendation is that the United States strongly support GATT, because it constitutes the most widely accepted international set of ground rules for international commerce. If the GATT should decline in influence, we foresee a drift toward bilateralism and protectionism, with adverse effects on investment, trade, and international financial stability.

To strengthen GATT, we recommend three steps: First, encourage accession by more developing countries to the GATT, and to the codes on nontariff trade barriers agreed to during the Tokyo Round. Second, make use of the negotiation and dispute resolution machinery of the GATT when possible, rather than to embark on private bilateral negotiations typified by orderly marketing agreements.

Third, we should press for the extension of GATT to services. Nontariff barriers to services constitute a significant impediment to worldwide expansion of the U.S. service industry.

Another way in which our Government should continue to support private investment initiatives abroad is through political risk insurance. We endorse the extension of the operating authority of the Overseas Private Investment Corporation [OPIC]. However, the private sector is becoming increasingly active in writing political risk insurance. We recommend that OPIC actively encourage this trend, since there is no compelling reason why our Government should be in the insurance business if the job can be handled by private industry.

For example, OPIC should consider offering reinsurance for political risk portfolios of private insurers.

Still another area in which our Government can support private foreign direct investment is in combating efforts in international forums to restrict the free flow of technology across national borders. In the United Nations, proposals for an international code on technology transfer contain provisions which would significantly dilute protection of industrial property rights and would discourage rather than promote the dissemination of technology.

We strongly endorse the firm stand taken by the United States in opposition to these provisions.

Another international initiative to weaken industrial property rights is a diplomatic conference in Nairobi on the revision of the 1883 Treaty of Paris for the protection of industrial property. We support the U.S. position, which is to oppose changes in the treaty which would diminish the rights of proprietors of technology.

Technology transfer is also a critical issue in the proposed treaty on the Law of the Sea. It contains proposals for the mandatory transfer

of ocean mining technology to an international seabed authority. Quite apart from the adverse effects on U.S. companies, which have spent millions of dollars in developing such technology, the proposed mandatory transfer provisions would set an unfortunate precedent, which would buttress Third World claims that technology is part of the "common heritage of mankind" which they should acquire without payment.

We believe the United States should seek modification of those proposals on mining technology.

Yet another area in which our Government should support foreign investment is tax policy. Frequently, proposals to change the rules for taxation of foreign source income are advanced without full consideration, full and coordinated consideration, of the effects on the competitiveness of U.S. companies operating abroad.

With respect to tax treaties, Mr. Chairman, which you mentioned, again, coordination with other investment objectives of the United States would be appropriate.

I would add that in a letter to you which I sent last week in connection with your consideration of tax treaties, that the National Foreign Trade Council did advocate that all such treaties include a provision on nondiscrimination against foreign national investors.

Finally, we believe that our Government can support U.S. private investment abroad by avoiding policies which would restrict foreign investment in the United States. Such investment is rapidly growing, and now exceeds $65 billion. It brings with it increased employment, flows of technology, and funds needed to improve the Nation's stock of property, plant, and equipment.

Traditionally, U.S. restrictions on foreign investment have been minimal, and we believe this longstanding policy should not be abandoned. Recent actions by Canada to reduce foreign investment in the energy sector and the laws of numerous foreign nations imposing a variety of conditions upon foreign direct investment, including, of course, performance requirements, generate pressures for the United States to retaliate by imposing similar conditions on foreign investors.

When two nations apply this principle of retaliation bilaterally, instead of the dismantling of one barrier, restrictions are imposed on both sides. While we favor strong and persistent efforts by our Government to dissuade foreign nations from imposing unnecessary restrictions on investment, we believe that retaliatory-in-kind legislation should be a last, not a first resort. A pattern of U.S. restraints on foreign investment would be interpreted abroad as a withdrawal from our commitment to a free and open international trading system. Moreover, it would slow down the flow of foreign capital and technology in the United States with adverse effects on the entire U.S. economy.

To conclude, both the United States and the world economy will benefit from a continuation of an open international investment system, with a minimum of governmental restrictions and a maximum emphasis on private initiative and market forces to achieve domestic and worldwide economic growth.

That's the end of my statement, Mr. Chairman.

[Mr. Roberts' prepared statement follows:]

Prepared Statement of Richard W. Roberts

Mr. Chairman, members of the Subcommittee, my name is Ricahrd W. Roberts, President of the National Foreign Trade Council. The Council, a private, non-profit business organization of more than 650 companies engaged in foreign trade and investment, appreciates your invitation to present its views on U.S. international investment policy.

We welcome the review of United States policy being conducted by the Subcommittee. We strongly subscribe to the view expressed by the Chairman that recommendations for U.S. international investment policy should be considered in a broad context comprehending international trade, investment and technology transfer. All three aspects are interwoven in the fabric of our country's foreign economic policy.

A major objective of the nation's foreign economic policy is the expansion of trade and investment through the reduction of arbitrary barriers to the free flow of goods, technology and capital. With respect to investment flows, a recurring policy question is what actions should be taken to support U.S. private direct investment abroad. Such investment, with a book value of $213 billion, expands the market for U.S. goods and services and provides a substantial inflow to the U.S. balance of payments.

HOST COUNTRY RESPONSIBILITIES

It should be recognized that the primary responsibility for attracting and retaining investment funds from the United States or other sources rests with host countries.

Nations seeking inflows of foreign capital for their economic development must provide a hospitable investment climate. A prime concern of investors is stability, which means clear and consistent investment-related laws and the reduction or elimination of arbitrary barriers to investment from abroad. Host country nationalization and expropriation of foreign investment, coerced sale of assets, confiscatory taxation and coerced contract-concession renegotiation all poison the investment climate, thereby discouraging needed investment.

Host countries should, therefore, provide non-discriminatory, national treatment consistent with international law standards for foreign investors, proscribe expropriation and eliminate barriers to profits remittances and capital repatriation.

Countries which fail to provide a secure and stable investment climate cannot expect private investors from abroad to make significant investment commitments; such countries are likely to become increasingly dependent on official aid. The United States and the multilateral development loan institutions in which the United States participates should, before making major aid commitments to individual countries, consider the extent to which such countries' investment policies may have foreclosed development by private capital.

U.S. GOVERNMENT ACTIONS

1. Enforcement of international law

While host countries have the primary responsibility for attracting capital, there are a number of actions which the United States can take to encourage private capital flows to foreign countries.

First, when U.S. private investment abroad is threatened with action which is not in accord with international law or applicable international agreements, the U.S. Government should take appropriate measures to discourage any such action and should insist that foreign governments observe undertakings freely entered into. It is a well established principle of international law that any taking of private property belonging to foreign nationals will be non-discriminatory aud for a public purpose, and that the owners of nationalized property will receive prompt, adequate and effective compensation from the expropriating country. Unless our Government provides support for American investors in such instances, they will be unwilling to assume the risks of making direct investments in many countries. In this connection we welcome recent statements by the Department of State that it is the responsibility of our government to provide full support for American investors whose investment interests are threatened by violations of international law and agreements.

In order to provide a mutually acceptable set of ground rules to deal with such critical investment issues as expropriation and national treatment, we strongly recommend that the United States vigorously pursue its program of negotiating bilateral investment protection treaties with developing countries. To date, we have been, in candor, disappointed with the progress of the United States in embarking on a treaty program. In the past five years no treaty has been signed. A treaty negotiation with Singapore is, we understand, at an impasse; a negotiation with Egypt is proceeding slowly. By contrast, West Germany has entered into about 50 such treaties, and the total number of treaties entered into by all countries, including such major trade competitors as Japan, France, Germany and the United Kingdom, totals about 175.

If the U.S. program under the Trade Representative's leadership is to move forward, more resources must be devoted to it. Investment in developing countries, such as those of the Caribbean area, which the United States views as in the national interest, will be enhanced if a network of bilateral investment treaties is speedily developed.

2. Develop rules regarding investment incentives and performance requirements

Second, our government can provide assistance to U.S. investors by working toward the reduction of performance requirements and investment incentives, which are prevalent abroad. We welcome recent statements by U.S. officials of their concern over the growing practice of host countries to use performance requirements and investment incentives to alter investment and trade flows by maximizing the flow of foreign investment into their economies on terms which are supportive of their national economic and social goals. The number of these incentives and restrictions is substantial, as nations find that adherence to the GATT codes on non-tariff barriers, agreed to during the Tokyo Round of multilateral trade negotiations, restricts intervention in trade flows.

The United States should use its position of world economic leadership in an international effort against the proliferation of performance requirements and in favor of creation of agreements to dismantle them where they now exist. By and large, both industrial nations and developing nations in the long run are hurt by performance requirements, which, like trade restrictions in general, create economic inefficiencies which can only rarely be justified by developing countries as helping to create an industrial base. For the most part, except where infant industries become world competitive reasonably quickly, the host country saddles itself with an industry costing its citizens more than they would pay in a free world market. Performance requirements use can never be justified by industrial nations. Because some U.S. businesses have been forced to adapt to performance requirements in host countries, it would be appropriate for the United States to urge a gradual dismantling process in order to provide time for transition to a freer environment. However, the U.S. Government should proceed cautiously in the use of actions to attack performance requirements in foreign countries, because of the potential for retaliation, which could damage the present world trading system.

Unless a set of internationally agreed rules or principles limiting the use of performance requirements and investment incentives evolves, government intervention rather than market forces will dominate international investment flows, and countries which fail to adopt such measures will be in effect the victims of countries which do so.

Some types of performance requirements such as minimum export levels appear to violate the Subsidy Code of the GATT; but most of such requirements are beyond the reach of the present GATT; therefore a set of ground rules must be fashioned to deal with initiatives which affect both trade and investment.

How should the United States proceed to develop an international consensus on measures to resolve the problem?

One possibility is to include in the bilateral investment treaty program a set of provisions on performance requirements and investment incentives. However, unless the bilateral investment treaty program is accelerated, we see little prospect for a significant reduction in the scope of the problem.

In our view, a multilateral approach appears preferable. One possibility is to amend the GATT to cover more explicitly trade-related performance requirements and to enlist the support of GATT members for specific provisions limiting performance requirements and investment incentives. We do not wish to be understood as advocating a GATT which would set forth detailed rules for investors and host countries respecting foreign direct investment. There has

been, as we discuss later, considerable effort by developing nations to obtain under U.N. auspices adherence to a series of Codes of Conduct for multinational corporations, involving rules for both trade and investment. These Codes, reflecting the desire of the third world to create a new international economic order, include, in drafts now being negotiated, many proposed provisions which discriminate against multinational corporations, and involve unreasonable interference by governments in international trade and investment flows. We are concerned that similar burdensome and counterproductive proposals might be advanced if a proposal to create a GATT for investment was initiated. Accordingly, we favor expanding the GATT Subsidy Code and GATT rules barring government intervention in trade flows to include increased protection for investments. Since trade and investment are inextricably linked in addressing performance requirements, it should be possible to deal with these broader issues in the context of the present GATT rules.

3. Support GATT

Our third recommendation is that the United States strongly support GATT, particularly in encouraging accession by more countries to the Codes agreed to during the Tokyo round. As this Committee is aware, developing countries, and non-market economies generally have not agreed to be bound by these Codes, which if properly enforced, will do much to reduce non-tariff barriers to trade.

While the GATT rules relate to trade, rather than investment, the GATT constitutes the most widely accepted international set of ground rules for international commerce. If the GATT should decline in influence, we forsee a return to bilateralism and protectionism, with major adverse effects on investment, trade and international financial stability. An objective of the GATT is an open international economic system; we think it important to strengthen this institution both to preserve the present international trading system and to provide a legal and institutional framework to resolve conflicts arising out of government intervention in investment flows.

4. Extend investment insurance

Another way in which our government can support private investment initiative abroad is through political risk insurance. Thus, we endorse the extension of the operating authority of the Overseas Private Investment Corporation. The private sector has become increasingly active in writing political risk insurance. We recommend that OPIC actively encourage the growth of the private sector and explore new ways of promoting such growth. This will add to the nation's underwriting capacity and serve to contain premium costs. For example, OPIC should consider offering reinsurance for political risk portfolios of private insurers.

The Council opposes an amendment recommended by the Foreign Relations Committee which would require OPIC to refuse to support investments subject to incentives or performance requirements which have the effect of diminishing positive trade benefits for the United States. Our government's efforts to deal with performance requirements abroad should not be the subject of a piecemeal approach which would necessarily occur if our initiatives were tied to applications for OPIC coverage.

To the extent that private insurance is not available, government insurance is a necessary element in the continued expansion of U.S. international investment. OPIC has demonstrated its important role as an effective partner of the private sector in maintaining U.S. leadership in international markets as well as in promoting the economic growth of developing countries.

5. Maintain the free flow of technology

Another area in which our government can support private foreign direct investment is in maintaining the free flow of technology across national borders. Our international economic policy, dedicated to an open trading system, properly places maximum reliance on market forces and on the free movement of capital, technology, goods and services. Our policy regarding the transfer of technology—no less than our trade policy—is linked to our open investment policy: the removal of arbitrary barriers must continue to be our objective.

The transfer of incoming technology is not hampered by any unrealistic United States restrictions. However outward technology transfer, which mutually benefits both the United States and host countries, is threatened by a proliferation of nationalistic restrictions on patent protection, especially in Latin America and in

Asia, and by proposals of the Group of 77 (now 122) developing countries in various international forums.

We strongly endorse the United States' firm stand against the dilution of protection for industrial property which is proposed by developing nations in the United Nations Conference on Trade and Development and UNCTAD's Draft International Code of Conduct on the Transfer of Technology.

We support the U.S. position in the Diplomatic Conference on the Revision of the Paris Convention, opposing efforts to weaken the 1883 Treaty of Paris for the protection of industrial property with provisions which would permit a country to grant exclusive non-voluntary licenses for any patent: this would allow others to benefit from the inventor's creation while excluding the inventor himself. The Council also has urged the U.S. delegation to maintain its continuing position that the rules of procedure for the conference require a unanimous vote for amendment of the treaty.

Similarly, we urge the U.S. delegation to the United Nations Conference on the Law of the Sea not to accede to any provisions for the mandatory transfer of ocean mining technology to an International Sea-Bed Authority. Quite apart from the adverse effects on U.S. companies which have spent hundreds of millions of dollars in developing such technology, the proposed transfer would set an unfortunate precedent which would buttress third world claims that technology is part of the "common heritage of mankind" which they should acquire without payment.

There is today a constant flow of technology from industrialized to developing countries on the basis of voluntary, freely negotiated contracts reflecting the mutual interests of both parties. We urge the Congress and the Administration to stand fast in opposition to international codes and conventions which would make technology transfer mandatory and interfere with the essential flow of technology.

6. Encourage inward investment

Finally, we believe that our government can support U.S. private investment abroad by avoiding policies which would restrict foreign investment in the United States. Such investment in the United States is rapidly growing and now exceeds $65 billion. It brings with it increased employment, flows of technology, and funds needed to improve the nation's stock of property, plant and equipment.

Traditionally, U.S. restrictions on foreign investment have been minimal. Except in the fields of telecommunications, nuclear energy, hydro-electric power, domestic air transport and shipping, the United States Government imposes few restrictions on foreign investment.

Recent actions by Canada to reduce foreign investment in the energy sector, and the laws of numerous foreign nations imposing a variety of conditions upon foreign direct investment, including performance requirements, will invite pressures for retaliatory measures by the United States in the form of overall U.S. restrictions on foreign investment or restrictions against individual countries.

When a foreign nation imposes restrictions on new, as opposed to existing investments, the most appropriate response by our government may be a policy of patience. Whenever a country imposes conditions on the entry of foreign capital or its employment, it runs the risk of excluding some of that capital. For example, the Andean Common Market, with its restrictions on foreign ownership and allied limitations, imposed unrealistic burdens on foreign investments and has failed to attract the capital needed for development. Some Andean pact members have dropped out, and others are revising their policies to remove disincentives to foreign investment. By contrast, countries such as Korea and Hong Kong, which maintain open investment policies, have flourished.

We are concerned over the possibility of retaliatory legislation pursuant to which the United States would impose substantially the same investment restrictions against particular foreign countries as those countries impose against United States investments. When two nations apply this principle of retaliation bilaterally, instead of the dismantling of one barrier, restrictions are imposed on both sides. We believe that the imposition of restraints on foreign investment by the United States would be interpreted abroad as a withdrawal from the United States commitment to a free and open international trading system, and would impede U.S. efforts to reduce existing limitations on foreign investments, just as U.S. efforts to impose our antitrust, antiboycott and other domestic laws outside the United States makes it more difficult for us to argue against extraterritorial laws enacted by our trading partners. Moreover, such a policy of

selective or general restrictions on foreign direct investment in the United States would slow down the flow of foreign capital and technology into the United States, with adverse effects on the entire U.S. economy.

Accordingly, we conclude that the soundest U.S. policy is to continue to welcome foreign capital and foreign technology, and to press through diplomatic means and ultimately through international agreements, for a relaxation of existing foreign country restrictions on investment.

SUMMARY

It is appropriate to re-examine our international investment policy at a time when the gap between the value of inward and of outward direct investment is narrowing, and pressures are mounting for greater control over foreign investment in the United States. We agree with the Administration that both the United States and the world economy will benefit from a continuation of an open international investment system, with a minimum of governmental restrictions and a maximum emphasis on private initiative and market forces to achieve domestic and worldwide economic growth.

The CHAIRMAN. Thank you very much, Mr. Roberts. I understand that your council will be meeting here in Washington this year.

Mr. ROBERTS. That is correct, on October 30. The subject of the meeting is the Nation's foreign economic policy. We will have a number of Government and business leaders take a look at that from a good many angles.

The CHAIRMAN. So, the question of investment policy will be receiving further attention from the council, then.

Mr. ROBERTS. Yes; very definitely.

The CHAIRMAN. I hope that this hearing today and the recommendations that we have received, including your own, will constitute a part of your discussion.

Mr. ROBERTS. They will, indeed. We are indebted to the two preceding speakers for some topics which require further exploration.

BUILDING WALLS BEFORE YOU CAN HAVE BRIDGES

The CHAIRMAN. How do you feel about the question that we have been discussing, that of whether or not you have to have walls before you can have bridges?

Mr. ROBERTS. I think that is a most pertinent observation. I suppose it goes to the question which Mr. Hufbauer first raised about whether the United States has sufficient leverage to achieve the kinds of international agreements which we would like to see; for example, bilateral treaties or a movement in the GATT to take care of performance requirements.

I would hope that the United States could achieve its aims through discussions and through diplomatic initiatives and through pressing for the rule of law abroad, and for the expansion of multilateral agreements, rather than to attempt piecemeal retaliatory efforts. We are, of course, the greatest market in the world, and if ultimately we find ourselves unable to make any progress, any meaningful progress in negotiations to provide a better climate for investment abroad, then we do have the final option of withholding in various ways portions of that market from foreign investors, but the risks are very high, and our own organization's view is that should be a last resort.

PERFORMANCE REQUIREMENTS IMPOSED BY DEVELOPING COUNTRIES

The CHAIRMAN. In the case of performance requirements imposed by developing countries, should we be a little more tolerant than in the case of developed countries?

Mr. ROBERTS. Well, like the two preceding speakers, I am not able to differentiate between developing and developed countries. As I am sure you are aware, Mr. Chairman, in the United Nations discussions of the various codes on restrictive business practices, on technology transfer, and on a code of conduct for multinational corporations, it has been the position throughout of developing countries that they are entitled to a special regime, which frequently is such a departure from the rules applicable to other trading nations as in effect to insulate them from these rules of the game.

We think a better approach is as soon as possible to bring the developing nations into the international trading system, which involves abiding by these rules. We are unable to see that there is a special claim why these trade distorting efforts, such as performance requirements, are better for developing than developed nations.

The CHAIRMAN. I would think your council meeting would be interested in the Price Waterhouse survey of investment policies in 73 countries. This is a very significant document, as you can see [indicating].

In its present form, it may be limited in distribution. Since Mr. Connor is still in the room, I might ask him to advise us or advise staff after the hearing as to what his attitude would be if we would include the full survey as a part of the record of this hearing.

I myself have some mixed feelings about it. Wearing another hat, I am chairman of the Joint Committee on Printing, and I have been exhorting everyone to print as little as possible. On the other hand, this seems to me to have some unique value. However, we can have a discussion about that after the hearing.

Mr. Roberts, we are very grateful to you for your statement and for your presence here today. I hope we can continue to stay in touch. We will follow the deliberations of your council meeting with great interest.

Mr. ROBERTS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

The record will remain open for 2 weeks, for the submission of additional material.

The subcommittee will stand adjourned, subject to call of the Chair.

[Whereupon, at 11:30 a.m., the subcommittee adjourned, subject to call of the Chair.]

U.S. POLICY TOWARD INTERNATIONAL INVESTMENT

WEDNESDAY, OCTOBER 28, 1981

United States Senate,
Subcommittee on International Economic Policy
of the Committee on Foreign Relations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 4221, Dirksen Senate Office Building, Hon. Charles McC. Mathias, Jr. (chairman of the subcommittee), presiding.

Present: Senator Mathias.

The Chairman. The subcommittee will come to order.

I want to welcome everyone this morning to this hearing that looks to a review of U.S. policy on international investment. I might say that this will be the third of a series of hearings on this general subject which has been conducted by the International Economic Policy Subcommittee.

This morning we are looking forward to receiving advice and counsel from the administration officials who have the responsibility for policy toward both foreign investment in this country and for U.S. investment abroad. International investment, of course, like international trade, is of necessity a two-way street.

At the end of 1980, Americans had investments abroad that were worth $213 billion, a sum almost beyond the dream of avarice.

Foreign investments in America are worth $65 billion. And I think the relationship of those figures is worth pondering a little, particularly in view of the state of public concern over foreign investment in the country today, that what we own abroad is more than three times what foreign interests own in this country.

So I hope we will not lose sight of the importance of keeping this two-way street open and free of barricades and potholes. Free international markets for investment and trade mean more jobs and higher earnings for Americans with lower inflation. We need to continue working toward the elimination of foreign barriers to U.S. commerce while avoiding adding to our own governmental impediments.

I believe our witnesses this morning share my view of the direction we should be taking, and I am anxious to hear how they will proceed. So without further ado, gentlemen, if you wish to give your opening statements in whatever order you have agreed upon, and as is the usual custom, your full written statement will be included in the record. You can summarize as you will.

Mr. Hormats. We will go alphabetically, Mr. Bale will go first.

Mr. Leland. Yugoslavia objected to that at Cancun.

STATEMENT OF HARVEY E. BALE, JR., ASSISTANT U.S. TRADE REPRESENTATIVE FOR INVESTMENT POLICY, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. Bale. Mr. Chairman, my name is Harvey Bale, Assistant U.S. Trade Representative [USTR] for investment policy in the office of the U.S. Trade Representative. I thank you and the members of this subcommittee for the opportunity to discuss a number of aspects of the Nation's international investment policy.

International investment policy is receiving priority attention from this administration. Several administration interagency groups, including the Trade Policy Committee and the Cabinet Council on Economic Affairs, are reviewing and developing U.S. policy in these areas.

International investment policy is being developed to reflect the goals of economic and trade policy overall; that is, to stimulate capital investment and economic growth at home and to maintain and strengthen an open world trading system.

First, a comment is in order, I believe, on the official U.S. policy regarding international direct investment. In 1977 the Carter administration issued a policy statement on this subject, the central theme of which is contained in the so-called neutrality clause. This states that it is U.S. policy neither to encourage nor discourage the inflow or outflow of international investment. The statement can be viewed as a noninterventionist liberal investment policy attitude, which this administration supports.

Unfortunately, the 1977 statement leaves the impression that the U.S. Government takes a handsoff policy toward international investment barriers. It has left our embassies in the position of encouraging and assisting U.S. exporters abroad but not U.S. investors.

In fact, the U.S. Government should not and does not have a neutral or benign neglect attitude toward foreign investment. For reasons brought up in other testimony and in the remarks that follow, the administration is actively pursuing three related objectives:

The first is the liberalization of barriers and the reduction of distortions to international investment abroad in both developed and developing countries. A reduction of the obstacles to U.S. investment abroad will enhance U.S. competitiveness in exports.

The second is the encouragement of a geater role for private foreign investment in the economic development of the LDC's. Foreign aid alone cannot sustain economic growth in the absence of greater participation by domestic and foreign entrepreneurial capital.

The third objective is the maintenance of the maximum degree of openness of the U.S. economy to the contribution of foreign direct investment. We have one of the, if not the, most liberal policies toward inward foreign investment with very few areas being restricted.

We should maintain this open policy. We do not want to damage the reputation of the United States for welcoming foreign investment with its benefits for creating jobs, introducing new techniques, and improving the financial vitality of the United States.

This "nonneutral" attitude toward foreign obstacles to U.S. investors and a positive attitude toward inward foreign investment are hallmarks of our basic policy. We will, of course, be in a stronger

position to resist efforts to restrict investment from overseas to the extent that we are successful in removing foreign obstacles to U.S. investment.

One fact clearly emphasized by most of the previous witnesses in these hearings is the close relationship between direct investment and trade. Witnesses made the case for the generally positive effect of U.S. investment abroad on U.S. exports. U.S. foreign investment creates opportunities for trade in new, and often protected, foreign markets.

U.S. foreign direct investment abroad also promotes economic development. In particular, in developing countries, it contributes to a higher standard of living and increases the financial means available for purchasing imports, including U.S. products.

For certain sectors of the U.S. economy, there is more than merely a positive association between U.S. foreign investment and exports. In fact, there is an absolute necessity to invest abroad in order to export.

This is very clear in the case of the services sector; for example, insurance, banking, and computer services. Possibilities for U.S. exports of many services such as these are extremely limited without the ability to establish branch activities abroad. And in the nonservice sectors, it is often essential to be able to establish foreign distribution and service centers in order to be able to sell into overseas markets.

It is because of the strong linkage between trade and investment that the USTR has a particular concern about investment barriers and distorting policies. An open international investment environment is essential for an open and expanding network of international trade.

Nevertheless, while successive rounds of negotiations have substantially reduced tariff barriers, and countries have begun to liberalize a number of nontariff barriers, restrictive and trade-distorting investment policies have become an increasing problem for the United States and other investing countries.

Because we have not yet adequately dealt with these problems certain trade-distorting investment policies have become more commonly used internationally. Much of the previous testimony dealt with trade-related performance requirements. In a U.S. paper recently presented to member countries of the GATT, we enumerated a number of types of performance requirements placed on foreign investors. These can be categorized primarily as exporting and importing requirements.

In the case of export performance requirements, foreign investors are required to export a minimum volume or percentage of their output, often as a condition for an investment incentive; for example, a tax holiday or production plus subsidy. This practice creates an export subsidy which runs counter to the recently negotiated GATT code on subsidies and countervailing duties.

Local-content or import-substitution requirements divert purchases by foreign-owned firms away from potentially more competitive foreign suppliers toward local producers. These local-content restrictions are, as witnesses in previous hearings have demonstrated, the functional equivalent of quotas, which also run counter to the GATT.

The administration's statement on U.S. trade policy, issued by Ambassador Brock last July, identifies the trade-related incentives

and performance requirements as measures which can distort trade as seriously as do tariff and nontariff barriers. These are a serious threat to the international trading system, because they have not been addressed sufficiently in the GATT.

The GATT is the logical institution to deal with this growing trade problem. We are attempting to initiate a work program in the GATT to address performance requirements. Useful work is also going on elsewhere.

We have launched an effort among the developed countries in the OECD to examine ways that investment incentives, disincentives, and investment barriers can be effectively addressed in that institution. The limitation of the OECD is that the greater number of countries, the LDC's which impose performance requirements and other disincentives to investment do not participate in the OECD.

However, much work needs to be done among developed countries. Furthermore, preparatory information-gathering and analysis can be done in the OECD among the developed countries in anticipation of negotiations in other forums among all countries.

In the IMF-World Bank Development Committee, where there is participation of both developed and developing countries, a study of the use and effect of investment incentives and disincentives will soon get underway. It may provide a valuable analytic base for making progress in dealing with incentive and disincentive policies.

The efforts that I have just described are multilateral in scope, designed to achieve ultimately an international discipline for investment incentives and disincentives through multilateral consultations and negotiations. However, it will take some time before they bear results. In the meantime, we must deal with the adverse consequences of performance requirements and other investment problems.

What can we do while we work toward multilateral agreements?

First, we can use the mechanisms of bilateral consultations to put forward our problems that we have with restrictions and burdensome investment policy in individual circumstances. We have used this mechanism most frequently with regard to our relations with our North American neighbors.

However, we need to become more aggressive in informing all of our trade partners of the degree of our concern over the use of performance requirements and, where our problems are serious enough, we should look at linkages with other various policies in other areas—for example, trade and aid—in order to make progress on these and other related investment matters.

We should seek an overall understanding on investment issues bilaterally with important developed and developing countries. The Bilateral Investment Treaty program, which the U.S. Government is initiating, may be able to deal with the problem in certain cases. The model U.S. Bilateral Investment Treaty contains provisions relating to the problem of performance requirements.

Another avenue by which to address performance requirements is to test the applicability of GATT rules against the trade problems they pose. We believe mandated local content and export performance requirements violate GATT provisions and agreements. We intend to test this belief. If the current rules are inadequate, then we will be in a position to strengthen them.

In connection with attacking performance requirements in the GATT, we must examine the use of U.S. law in regard to this problem. Section 301 of the 1974 Trade Act permits the President to take action against imports of countries whose policies restrict or burden U.S. Commerce. We interpret section 301 to cover foreign investment restrictions and trade-distorting investment policies.

I might add at this point that the United States is taking other initiatives with regard to the developing countries. It involves a number of multilateral, unilateral, and bilateral efforts, including bilateral investment treaties, which we believe will make some progress in stimulating and protecting U.S. investment in developing countries.

The U.S. Trade Representative's Office, in working with Treasury, State, Commerce, and other agencies, is particularly concerned about getting a program underway on performance requirements and bilateral investment treaties.

Let me just say, in conclusion, that on an individual country level, there are a number of pressures toward protectionism. If each country is allowed to follow this course, we all end up as net losers. For this reason most countries see the need for negotiations in a multilateral forum with the objective of reducing government-imposed trade barriers. For most of the developed countries, the Kennedy and Tokyo Rounds of the MTN have effectively eliminated tariffs as a significant source of protectionism for manufactured goods. The average tariff rate for manufactured products among developed countries are now down to 5 percent.

The Tokyo Round also made significant progress in eliminating many of the nontariff barriers for trade. Codes of conduct were established for subsidies and countervailing duties, antidumping, government procurement, standards, customs valuation, and licensing.

It appears that countries are, however, increasingly using investment as a means to protect and develop their market. If we and our trading partners are to continue to reap the benefits of our previous efforts in the Kennedy and Tokyo Rounds, we must arrest and push back trade-limiting and distorting investment policies which threaten the future of the open world trading system.

Thank you, Mr. Chairman.

[Mr. Bale's prepared statement follows:]

Prepared Statement of Harvey E. Bale, Jr.

Mr. Chairman I am Harvey Bale, Assistant U.S. Trade Representative for Investment Policy in the Office of the U.S. Trade Representative. I thank you and the members of this Subcommittee for the opportunity to discuss a number of aspects of our nation's international investment policy. This hearing is a continuation of an important series of hearings of this subcommittee covering a matter of great concern to U.S. trade and economic policymakers. I am convinced that this series, which allows both private and public sector representatives to comment, will contribute positively and substantially toward the planning of our work program in the international trade and investment areas. In my remarks today, I intend to review several aspects of our work program and to comment on some of the views presented in the hearings held on July 30 and September 28.

THE OVERALL U.S. INVESTMENT POLICY

First, a comment is in order on the official U.S. policy regarding international direct investment. In 1977, the Carter Administration issued a policy statement on this subject, the central theme of which is contained in the so-called "neutrality" statement. This states that it is U.S. policy neither to encourage nor discourage the inflow or outflow of international investment.

This statement *can* be viewed as a non-interventionist, liberal investment policy attitude—which this Administration supports. It is in the interests of our country and other countries of the world—especially LDC's—to have capital flowing as freely as possible. The free flow of capital as well as goods, will tend to support the goals of sound economic policy and maximize economic growth at home and abroad.

Unfortunately, the 1977 statement leaves the impression that the U.S. Government takes a hands-off policy toward international investment barriers. It has left our embassies in the position of encouraging and assisting U.S. exporters abroad—but not U.S. investors. In fact, the U.S. Government should not and does not have a neutral or benign-neglect attitude toward foreign investment. For reasons brought out in other testimony and in the remarks that follow, the Administration is actively pursuing three related objectives. The first is the liberalization of barriers and reduce distortions to international investment abroad in both developed and developing countries. Reduced obstacles to U.S. investment abroad will enhance U.S. competitiveness and exports. The second is the particular encouragement of a greater role for private foreign investment in the economic development of the less developed countries. Foreign aid plans cannot sustain economic growth in the absence of greater participation by domestic and foreign entrepreneurial capital. The third is the maintenance of the maximum degree of openness of the U.S. economy to the contribution of foreign direct investment. We have one of the—if not *the*—most liberal policies toward inward foreign investment, very few areas are restricted.

We should maintain this general open policy. We do not want to damage the reputation of the United States for welcoming foreign investment, with its benefits for creating jobs, introducing new techniques and improving the financial vitality of the United States. The non-neutral attitude toward foreign obstacles and a positive attitude toward inward foreign investment are hallmarks of our basic policy. We will, of course, be in a stronger position to resist efforts to restrict investment from overseas if we are successful in removing foreign obstacles to U.S. investment.

THE INVESTMENT-TRADE LINK

One fact clearly emphasized by most of the previous witnesses in these hearings is the close relationship between direct investment and trade. These witnesses have made the case for the generally positive effect of U.S. investment abroad on U.S. trade. U.S. foreign investment create opportunities for trade in new, and often protected, foreign markets. U.S foreign direct investment abroad also promotes economic development abroad and, in developing countries, a higher standard of living and greater financial means for purchasing imports, including U.S. products.

Part of the link between U.S. foreign investment and U.S. trade is provided by U.S. affiliates. According to the Commerce Department, in 1977 roughly one-third of all U.S. exports were traded between U.S. companies and affiliates of U.S. companies abroad. The Commerce data also suggest that for every \$100 of manufactures that we imported from U.S. affiliates abroad, there are \$160 of U.S. exports of manufactures to foreign U.S. affiliates. Thus, there appears to be a significant, positive association between U.S. foreign direct investment and the net U.S. exports of goods and services. (Except in the areas of petroleum and mineral extraction, where U.S. foreign investment is carried out for the purpose of importing necessary basic minerals and fuels into the United States.)

For certain sectors of the U.S. economy, there is more than merely a positive association between U.S. foreign investment and exports. In fact, there is an absolute necessity to invest abroad in order to export. This is most clearly the case in the services sector—e.g., insurance, banking, and computer services. Possibilities for U.S. exports of many services, such as these, are extremely limited without the ability to establish branch activities abroad, and in the non-service sectors, it is often essential to be able to establish foreign distribution and service centers in order to be able to sell into overseas markets.

BARRIERS TO INVESTMENT

It is because of the strong linkage between trade and investment that the USTR has a particular concern about international investment barriers and distorting policies. An open international investment environment is essential for an open and expanding network of international trade. Nevertheless, while successive

rounds of negotiations have substantially reduced tariff barriers and countries have begun to liberalize a number of non-tariff barriers, restrictive and trade-distorting investment policies have become an increasing problem for the United States and other investing countries. Because they have not been adequately dealt with, certain trade-distorting investment policies have become more commonly used internationally. Furthermore, there is a certain urgency in dealing with the problem of investment barriers because, as Alan Wolff indicated in earlier testimony, as these policies "become more widespread and integrated into the global economic structure, it will be increasingly difficult to gain discipline over their use."

The absence of significant progress in dismantling interventionist foreign investment policies—indeed, in preventing at least until now, the further spread of new forms of intervention—is largely due to the fact that while this country believes that liberal economic policies should generally apply to both international flows of goods *and* investment, other countries do not. While accepting the rules the GATT which constrain the use of restrictive trade policies, other countries often intervene heavily in the investment decision process by (1) imposing obstacles to the entry of foreign investors into their country; (2) discriminating against foreign investors in the administration of tax, subsidy, and import and export licensing policies; and (3) frequently linking the permission for entry of foreign investment or the provision of investment incentives to certain "performance requirements."

These problems arise in a number of developed, as well as developing countries. However, it is in the LDC's where strongly interventionist policies are most prevalent. We must deal with serious investment barriers and distortions in both developed and developing countries.

TRADE-RELATED PERFORMANCE REQUIREMENTS

Much of the previous testimony dealt with performance requirements of various kinds. In a U.S. paper recently presented to the member countries of the GATT, we enumerated a number of types of performance requirements placed on foreign investors. These include:

(1) Export requirements; (2) requirements regarding import substitution; (3) requirements relating to size (e.g. capital invested or employment levels); (4) requirements regarding industrial sectors or specific industries; (5) requirements regarding location of industry; (6) requirements limiting foreign ownership (or providing for local participation); (7) requirements regarding employment of foreign nationals (or the Employment of nationals, especially in technical and managerial positions); (8) requirements relating to investor financing and access to local capital; (9) restrictions on the remittance of earnings and the repatriation of capital; and (10) requirements concerning the introduction of new products and new or high-level technology.

Each of these types of requirements are of concern to us in individual investment cases; however, the first two—export and import substitution requirements—have a direct impact on U.S. trade.

In the case of export performance requirements, foreign investors are required to export a minimum volume or percentage of their output, often as a condition for an investment incentive—e.g. a tax holiday or produced on cost subsidy. This practice creates an export subsidy which runs counter to the recently-negotiated GATT code on subsidies and countervailing duties.

Local content or import substitution requirements divert purchases of foreign-owned firms away from sometimes preferred foreign suppliers toward local producers. These local content restrictions are, as witnesses in previous hearings have argued, the functional equivalent of quotas, which also run counter to the GATT.

The Administration's "Statement on U.S. Trade Policy," issued last July, identifies trade-related incentives and performance requirements as measures which can distort trade as seriously as do tariffs and non-tariff barriers. These are a serious threat to the international trading system because they have not been addressed sufficiently in the GATT. The GATT, meanwhile, is the prime logical institution to deal with this growing trade problem.

We are attempting to initiate a work program in the GATT to address performance requirements. There is a natural reluctance on the part of other countries which use performance requirements to discuss the problems these policies present. In response to our request GATT Secretariat has produced a paper for

GATT member countries which discusses the relation of these practices to the GATT articles and the work that is going on in the OECD and elsewhere on this issue. I am hopeful that at the planned meeting of GATT trade ministers in late 1982 we will see the launching of a multilateral work program to bring discipline to the use of trade-related performance requirements.

Useful work is also going on elsewhere. We have launched an effort among the developed countries in the OECD to examine ways that investment incentives, disincentives and investment barriers can be effectively addressed in that institution. A limitation of the OECD is that the greater number of countries—the LDC's—which impose performance requirements and other disincentives to investment do not participate in the OECD. However, much work needs to be done among developed countries. Furthermore, preparatory information-gathering and analysis can be done in the OECD among the developed countries in anticipation of discussions among all countries in other forums.

In the IMF/World Bank Development Committee where there is participation of both developed and developing countries, a study of the use and effect of investment incentives and disincentives will soon get underway. This study is expected to be completed late in 1982, and will hopefully shed further light on the impact and cost of these policies to developing investment-Host countries. It may provide a valuable analytical base for making progress in dealing with incentives and disincentives.

The efforts that I have just described are multilateral in scope, designed to achieve ultimately an international discipline for investment incentives and disincentives through multilateral consultations and negotiations. However, it will take some time before they bear results. In the meantime, we must deal with the adverse consequences of performance requirements and other investment problems. What can we do, while we work toward multilateral agreements?

First, we can use the mechanisms of bilateral consultations to put forward our problems with restrictions and burdensome investment policies in individual circumstances. We have used this mechanism—most frequently with regard to our relations with our North American neighbors; however, we need to become more aggressive in informing all of our trade and investment partners of the degree of our concern over performance requirements. And where our problems are serious enough, we should look at linkages with policies in other areas—e.g., trade and aid—in order to make progress on these and other related investment matters. We should seek an overall understanding on investment issues bilaterally with important developed and developing countries. The bilateral investment treaty program, which the U.S. Government is initiating, may be able to deal with the problem in certain cases. The model U.S. treaty contains provisions relating to the problem of performance requirements.

Another avenue by which to address performance requirements is to test the applicability of current GATT rules against the trade problems that they pose. We believe that mandated local content and export performance requirements violate GATT provisions and agreements. We intend to test this belief; if the current rules are inadequate, then we will be in a position to seek to strengthen them.

In connection with attacking performance requirements in the GATT, we must examine the use of U.S. law in regard to this problem. Section 301 of the 1974 Trade Act permits the President to take action against imports of countries whose policies restrict or burden U.S. commerce. We interpret Section 301 to cover foreign investment restrictions and trade-distorting investment policies.

I must mention a problem that the Government has, however, in dealing with performance requirements. Our ability to take action in the GATT and under Section 301 is constrained by the lack of information from U.S. investors. U.S. investors are reluctant to disclose details of their problems with foreign investment authorities because of their fear of retribution by the host government. Many performance requirements are levied administratively rather than from written rules and regulations. We need the assistance of the private sector in improving our information about the use of these performance requirements.

AN EXAMPLE: CANADIAN INVESTMENT AND ENERGY POLICIES

A number of the issues that I have raised arise in our investment relations with Canada. We have had a large and mutually beneficial trade and investment relationship with Canada for many years. Canada and the United States are each other's largest trade partners. Two-way trade is approaching $90 billion

this year. The total investment that has been built up between the two countries now totals $55 billion.

While current figures would indicate a healthy bilateral trade and investment condition, recent trends are disturbing. There is a divergence in the economic philosophies of the Governments of Canada and the United States. Canada's economic policies aim at a greater role for government in the economy. Also, Canada is pursuing a policy of economic nationalism, which is in reaction to the sizable degree of foreign ownership of Canadian industry.

We have to respect the differences in approach of our neighbors; however, Canadian policies contain elements which are not consistent with Canada's international commitments. Our current major problems rest in the implementation of Canada's Foreign Investment Review Act of 1974 and the National Energy Program; announced last year.

Investment policy: FIRA

The Foreign Investment Review Agency (FIRA), which implements the 1974 Act, was established to increase Canadian control and ownership of investment in Canada and to ensure benefits for Canadian firms from such investment. While we may disagree with it, we do not challenge either FIRA's existence or its screening of new foreign investment, nevertheless, we find its administration objectionable.

As a condition for new foreign investment, FIRA signs legally-enforceable performance requirement agreements with foreign investors specifying that firms buy Canadian goods. This is in violation of the provisions of GATT that require equal treatment between imported and domestic products. FIRA may also require firms to export a specific share of their Canadian production, which can distort trade flows. Foreign firms may also be prevented from distributing their products in Canada, which can seriously restrict trade. FIRA also prevents foreign firms from freely selling their assets in Canada to other non-Canadian firms, even though there is no increase in foreign ownership. This can reduce the value of foreign-owned assets in Canada.

The NEP

Canada's National Energy Program (NEP) has as its aims: Increasing Canadian ownership and control of the energy industry; achieving Canadian self-sufficiency in energy by 1990; altering the distribution of revenue from energy production; and increasing emphasis on exploitation—especially by Canadians—of territories under the federal government's jurisdiction. The major pieces of the NEP implementing legislation are scheduled to be considered during this session of parliament.

Our concerns about the NEP relate to a number of aspects, including the lack of adequate compensation for Canadian Government shares of leases on Canadian federal lands, the lack of national treatment in providing incentive payments for exploration and development activities in Canada and restrictions on export licenses. In connection with my earlier discussion of performance requirements, I want to mention, in particular, another aspect of Canada's NEP. Canada had previously removed objectionable implementing provisions of its NEP which would have favored Canadian suppliers of oil and gas equipment and services. However, the Government of Canada in August established a Committee on Industrial and Regional Benefits (CIRB) as part of a new federal program to insure that the benefits of major energy industrial projects go to Canadian firms.

In light of our experience with FIRA, the CIRB appears to signal that when there are two "competitive bids," energy firms are expected to "buy Canadian." Energy firms who don't select a Canadian supplier will have to justify their selection. We believe that activities of the CIRB would be in violation of the GATT.

The United States has responded to the FIRA and the NEP by holding a number of high-level consultations with the Government of Canada. The President himself has raised our concerns on several occasions. The Canadians so far have indicated that they do not intend to extend NEP-like policies to other sectors; nor do they intend now to make FIRA more restrictive. In fact, it appears that FIRA is undergoing a review. We cannot say at this time, however, that we will like it any more later than we do now.

Work on this issue and bilateral consulatations are continuing. Secretary Regan recently visited Ottawa to discuss our concerns. The Trade Policy Committee has been deliberating since the summer as to what our policy and approach

to Canada should be. Our approach to Canada will depend on its willingness to live up to its international obligations. We would welcome a return to full cooperation in making progress on a wide range of economic and trade issues.

DEVELOPING COUNTRIES AND U.S. PRIVATE INVESTMENT

As I mentioned early in my remarks, a second major goal of U.S. investment policy is the encouragement of flows of private direct investment into developing countries, particularly those which are least developed. The President has underscored the importance of this goal with the heads of state of other major countries in meetings at Cancun and Ottawa.

U.S. private direct investment has contributed significantly to the economic development of the LDC's. U.S. investment in the LDC's in 1980 reached $53 billion, representing a 174 percent increase over the U.S. investment position in 1970. U.S. investment flows to LDC's have represented approximately 50 percent of the investment by all OECD countries into the LDC's.

Our private direct investment in LDC's represents, however, only 20 percent of our total foreign investment; furthermore, the large majority of the increase in U.S. investment in LDC's since 1970 has been concentrated in relatively few countries—Bermuda, Brazil, Mexico, the Bahamas and Panama. These five countries account for 75 percent of the increase in U.S. investment between 1970 and 1980. Furthermore, much of the increased U.S. investment in these countries is related to financial activities, e.g., in the Bahamas and Bermuda. While it should be expected that special circumstances including the size and growth of the local economy and special incentives should result in some concentration of investment in these countries, there are obviously impediments working against greater U.S. investment in other developing countries. Primarily, it is the current attitude of many LDC governments toward foreign investment, as well as the perceived political risks associated with investing in many of the LDC's.

The Administration is working to draw greater private sector resources of the United States, of other developed countries, and of the developing countries themselves into the pursuit of economic growth in the LDC's. Appropriate measures encompass unilateral, bilateral and multilateral approaches to fostering greater private investment.

Unilaterally, the United States is supporting foreign investment in developing countries by: (1) acting to strengthen the U.S. economy in order to maintain a prosperous and open market for the products of new investment projects in LDC's (one-half of the manufacture exports of LDC's to OECD countries go to the United States in spite of the fact that the United States' economy is only one-third of the total size of all OECD economies); (2) expanding the range of the operations of OPIC to reduce the political and expropriation risks facing U.S. investors in developing countries; (3) channeling more AID assistance activities into greater support for the creation of greater management and technical skills necessary to attract investors in LDC's; (4) lessening the burden of disincentives to U.S. business activities in LDC's, including modification of the foreign Corrupt Practices Act to more clearly define illegal activities under the Act.

Bilaterally, the Administration is working to support U.S. investors in developing countries by initiating a series of bilateral investment treaties (BIT's), The model U.S. treaty addresses a number of areas of concern to U.S investors: (1) favorable treatment of U.S. investors and their activities on a national treatment or most-favored-nation basis; (2) avoidance of trade and investment restricting performance requirements; (3) the permission of transfer of earnings and capital in and out of host countries; (4) the provision for prompt and effective compensation in expropriation cases; and (5) procedures for the resolution of investment disputes. By agreeing to a bilateral investment treaty, a country which desires to attract U.S. investment will agree to general and specific commitments which will be welcomed by U.S. investors. We expect positive benefits in terms of the flow of U.S. investment for countries which sign on to a BIT.

Other developed countries have negotiated many such treaties. Our effort is just beginning. We have consulted with a number of people in the private sector and are beginning to consult with Congressional staff over a final draft. We have identified a number of countries which will welcome initial bilateral consultations concerning a possible BIT. Egypt, which is seeking to strengthen its private sector, is a country with whom we expect to begin early negotiations. There are also a number of countries in the Caribbean, Asia and Latin America which have indicated interest.

This fall, I expect to see negotiations underway with several countries. Besides Egypt, the Caribbean will take priority in our initial work. BIT's are part of a

broader effort there to improve the economic and social climate in the Caribbean Basin through a combined aid, trade and investment program. A large part of the Administration's Caribbean Basin Initiative is to promote greater private sector activity—both foreign and domestic. Work on investment-facilitating initiatives is underway. We are also consulting with representatives of the governments in the Caribbean Islands and Central America to determine the most effective program for this region.

Multilaterally, the Administration is working to support foreign investment in developing countries by (1) encouraging developing countries, at Cancun and elsewhere, to pursue economic reform, including the relaxation of economic controls placed on activities of the private sector; (2) promoting greater use of investment syndicating facilities such as the International Finance Corporation (IFC) which participates in or co-finances private investment projects in developing countries (since its inception in 1956 the IFC has invested $4.1 billion in 600 investments which have a total value of $18.5 billion; the IFC is promoting private enterprise and the participation of foreign investors currently in over 70 developing countries, which improves the general climate in LDC's for U.S. investors); and (3) encouraging the study of a new multilateral insurance program, similar to OPIC at the national level, which might broaden the international financial base for investment insurance in developing countries; this mechanism has been proposed before and it faces major obstacles today; however, it deserves serious attention as a facilitator of foreign investment and economic development in the poorer LDC's.

In my remaining remarks, I will address more specifically some of the views and recommendations of earlier witnesses in this series of hearings.

I believe that there is a close correspondence between the views expressed today and those given earlier on the major problems that our investment policy must address—i.e., foreign barriers to investment, lack of national treatment, the imposition of performance requirements, and the special problems of private investment in LDC's. In addition, most of the recommendations contain useful suggestions for consideration or implementation by the Administration and the Congress. I agree wholeheartedly on the value of testing existing GATT and other bilateral and multilateral instruments for dealing with trade-related performance requirements. We haven't been aggressive enough in dealing with performance requirements in the past. I also strongly agree on the value in negotiating treaties for the encouragement and protection of investment with developing countries.

I do not interpret the recommendations that have been made in previous testimony for a "GATT for Investment" as meaning that we should move toward creating a new international institution for investment problems. Rather, the recommendation reflects a gap in the international rules contained in the GATT and OECD. We should try to build the current rules and agreements in these two institutions to cover investment issues more adequately. We also hope that the potential leverage of the IMF and World Bank can be used effectively to liberalize LDC investment policies.

Concerning the recommendation for increasing the role for private action against performance requirements, this idea deserves attention. I am not convinced, however, that we have sufficiently utilized our current legislative tools for dealing with performance requirements.

Earlier testimony pointed to difficulties in negotiating Bilateral investment treaties with advanced developing countries, such as Singapore and Brazil. In fact, there was an effort to negotiate a BIT with Singapore two years ago, which failed. It has been suggested that bilateral tax treaties may provide leverage in improving the conditions for U.S. investment abroad and in negotiating BIT's. For several reasons, I think that the tax leverage is limited: In our tax treaties, we seek to obtain satisfactory treatment of the sizable U.S. overseas income, as well as information disclosure to aid in the enforcement of U.S. tax law. Also, the United States has been reluctant to grant treaty tax concessions (i.e., tax sparing) which have often been requested by LDC's. Nevertheless, I agree that we should, where feasible, carefully examine tax treaties in the broader context of international investment and other economic issues.

CONCLUSION

On an individual country level there are pressures toward protectionism. When each country is allowed to follow this course, we all end up net losers. For this reason most countries see the need for a multilateral forum whose objective is to reduce government imposed trade barriers.

For most of the developed countries the Kennedy and Tokyo rounds of the MTN have effectively eliminated tariffs as a significant source of protectionism for manufactured goods. The average tariff rate for manufactured products is five percent.

The Tokyo Round also made significant progress in eliminating many of the non-tariff barriers to trade. Codes of conduct were established for subsidies and countervailing duties, anti-dumping, government procurement, standards, customs valuation, and licensing.

It appears that countries are increasingly using investment as the means to protect and develop thir market. If we and our trading partners are to reap the benefits of our previous efforts in the Kennedy and Tokyo Rounds then we must arrest and push back trade-limiting and distorting investment policies which threaten the future of the open system of world trade.

The CHAIRMAN. Thank you, Mr. Bale.

Mr. Waldmann.

STATEMENT OF RAYMOND J. WALDMANN, ASSISTANT SECRETARY FOR INTERNATIONAL ECONOMIC POLICY, U.S. DEPARTMENT OF COMMERCE

Mr. WALDMANN. Thank you, Senator. I thought we might go alphabetically, but if we go in order of departments, I would be next.

Mr. HORMATS. Fair enough.

Mr. WALDMANN. I have a very brief statement to give, Senator.

We believe that direct investment, both inward and outward, plays an important role in world economic growth and development, and we believe that international investment generally will result in the most efficient allocation of economic resources if it is allowed to flow according to market forces with a minimun of Government intervention.

Many foreign governments, however, have resorted to interventionist measures to attract and channel incoming foreign investment. The most disturbing of such interventionist measures are incentives, performance requirements, and exceptions to national treatment, which Mr. Bale has just spoken about.

We are undertaking a series of initiatives in a variety of international fora on these issues. At the OECD's high-level executive committee in special session 2 weeks ago, we presented a new U.S. initiative which covered these three issues: Trade-related incentives and performance requirements, national treatment, and investment flows to developing countries. We received support from the executive committee and the OECD will expand its work program accordingly.

In line with the Department of Commerce's own work, I would like to mention a new study, entitled "The Use of Investment Incentives and Performance Requirements by Foreign Governments," which we are releasing today and which I believe the committee has copies of.

Our major finding in that study is that the use of investment incentives and performance requirements to achieve national economic goals is widespread among our major trading partners. On the average, about one-quarter of all U.S. affiliates overseas have received one or more incentives to invest, mostly in the form of tax concessions.

There is a wide variation from country to country in the percentages of companies receiving these incentives. Ireland, for example, has

granted one or more incentives to more than two-thirds of the affiliates of U.S. companies established in that country. And South Korea was second in percentage, with 53 percent of U.S. affiliates receiving these incentives. At the other end of the scale, Hong Kong was the lowest, with only 5 percent of the affiliates receiving an incentive.

The other issue examined was the imposition of performance requirements. The survey showed that 14 percent of U.S. affiliates overseas were subject to one or more of these requirements, including minimun export requirements, maximum import levels, minimum local-input levels, and minimum local labor content requirements.

A greater proportion of affiliates operating in developing countries had to comply with performance requirements than those affiliates operating in developed countries. Developing countries subjected U.S. affiliates to performance requirements only slightly more often than they granted incentives, while developed countries typically granted U.S. affiliates incentives far more often than they imposed performance requirements.

We have been involved in bilateral discussions with a number of countries on their policies which either inhibit the flow of foreign investment or imposed burdens or added costs on U.S. investors. For instance, I recently discussed Yugoslav patent, trademark, and joint venture laws with Yugoslavian officials, and I hope there will be some opportunities for improvement in the situation in that country with respect to U.S. investors.

We are, of course, concerned about the spread of performance requirements in Canada through its Foreign Investment Review Agency [FIRA]. We have been deeply involved in discussions with the Canadian Government. In order to receive specific information on the types of commitments companies have been making to Canada's FIRA, we have been sending questionnaires to over 1,000 companies. Responses indicated many firms made commitments to increase exports, reduce imports, and conduct research and technology development in Canada. Many companies stated they find FIRA procedures burdensome. Negotiations with FIRA are often prolonged, procedures and standards are not published, and doubts remain as to how the Canadian Government reaches a judgment about a new investment.

The Department of Commerce's Office of International Investment is also examining the issue of U.S. foreign investment in Japan, in an attempt to determine what, if any, factors may be inhibiting the flow of investment there.

In all of these cases, we encourage companies to discuss with us problems they may be experiencing in the investment area, including their specific problems with incentives, performance requirements, expropriation, or any other investment-related matter.

In addition, we now have within Commerce the Foreign Commercial Service, which gives us a way to deal with these problems on the spot.

To sum up, Mr. Chairman, the Department supports the continuation of the U.S. Government's traditional posture of openness and neutrality toward international investment. We are working to reverse the worldwide trend toward Government intervention in

the investment process. We are attempting to dismantle or at least minimize barriers to international investment. We believe that multinational corporations can and do make enormous contributions to global economic growth and development, and we believe we must develop international understandings and resolve problems that stand in the way of a more open global investment system.

Thank you.

[Mr. Waldmann's prepared statement follows:]

Prepared Statement of Raymond J. Waldmann

Mr. Chairman, I appreciate the opportunity to appear before this Subcommittee to present the Department of Commerce's views on U.S. policy toward international investment, including foreign investment in this country and U.S. investment abroad. I commend the Subcommittee greatly for initiating debate on this topic. I believe the issue of international investment could well dominate the entire field of international economic policy in this decade. I have read with interest the statements made by other witnesses and will address some of their major observations.

At the outset, let me state my belief that both the United States and the world economy benefit from an open international investment system—one that relies on market forces and has a minimum of government restrictions. Direct investment, both inward and outward, has an important role in world economic growth and development, and we must make every effort to facilitate its flow. As President Reagan told the World Affairs Council of Philadelphia the other day, when he called on the Third World to develop free market economies to overcome their economic difficulties, "Investment is the life blood of development.'

INTERNATIONAL DIRECT INVESTMENT POLICY

The traditional U.S. policy of neutrality toward foreign direct investment is based on our long-standing commitment to an open, competitive international economic system. We believe that U.S. and world economic welfare is best served by the maintenance of an international environment in which the free flow of trade, investment, and finance among nations can make its fullest contribution to non-inflationary economic growth and development. We respect the right of each country to determine, in accordance with its own goals and priorities, the environment in which foreign investment takes place in its territory. However, once investments have been made on that basis, we believe governments should not discriminate against them on the basis of nationality.

This policy is based on four premises:

First, international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces.

Second, there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest.

Third, unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments with adverse effects on the U.S. economy and U.S. foreign policy.

Fourth, the United States has an important interest in seeking to assure that established investors receive equitable and non-discriminatory treatment from host governments.

The general policy of the United States is to admit and treat foreign investment on a basis of equality with domestic investment. There are a number of relatively minor exceptions, however. We have restrictions at the Federal level to foreign investments which have national security significance, involve the exploitation of certain natural resources or are of a fiduciary nature. Hence, foreign nationals are limited in their share of ownership of enterprises engaged in coastal or inland shipping, domestic radio communication, domestic air transport, hydroelectric power production or the production or use of atomic energy. These restrictions are accepted by most nations as legitimate exceptions to national treatment. A number of States also have limited restrictions on foreign investment in such areas as banking, insurance, and land ownership.

BENEFITS OF AN OPEN INVESTMENT REGIME

There is general agreement that foreign investment can bring significant benefits to home and host countries. It provides capital to expand industrial capacity, increases exports, creates new employment opportunities, provides new technologies, and encourages competition and provides additional tax revenues.

The record of foreign direct investment in the United States and U.S. investment abroad clearly demonstrates the merits of a favorable investment climate. A recent Department of Commerce survey showed that, in 1979, affiliates of foreign firms in the United States provided 1.6 million jobs and paid compensation of about $30 billion to their employees. They spent almost $10 billion for new U.S. plant and equipment and contributed about $1.5 billion to research and development. Their exports of goods, valued at $43 billion, assisted our balance of payments situation. In addition, net income from U.S. direct investment abroad contributed almost $37 billion to our balance of payments in 1980.

TRENDS IN U.S. FOREIGN DIRECT INVESTMENT

Until the mid-1970's, U.S. direct investment overseas experienced an unprecedented growth, increasing more than tenfold from almost $12 billion in 1950 to some $140 billion in the mid-1970's. Essentially three factors accounted for this trend: (a) international investment capital was readily available; (b) the investment climate in developed countries (where more than two-thirds of total U.S. investments were located) was relatively stable; and (c) rapid economic growth, especially in the developed countries, promised higher profits than at home.

That picture changed when worldwide economic conditions took a downturn in the early 1970's. Financial resources became much more limited; costs of energy and other resources rose significantly; and high interest rates and sluggish economic conditions added unexpected financial burdens on national budgets. In an effort to create new jobs, and support existing ones, expand exports, acquire new technologies and earn more foreign exchange, increased foreign investment became a priority objective for many foreign countries and U.S. States. Because of the low value of the dollar on international money markets and the relative stability of the United States, foreign direct investment in the United States increased from $13 billion in 1970 to $65 billion at year-end 1980.

Many foreign governments, however, have resorted to interventionist measures to attract and channel incoming foreign investment. This has had the effect of distorting the flow of international investment and trade. The most disturbing of such interventionist measures are incentives, performance requirements, and exceptions to national treatment.

INCENTIVES

To attract foreign investment, many governments now offer a wide variety of incentives, including tax credits and interest subsidies. These measures can lead to a shift of production, jobs, exports, technologies, and tax revenues to countries offering the most attractive investment package in situations where economic considerations would not have warranted such a move. A recent study in the OECD (Organization for Economic Cooperation and Development) on the effects incentives have on management decision-making found that incentive programs may be an important consideration in the choice of an investment site in goegraphically close areas and in the timing of the investment. Such incentives are of dubious value to the country offering them since they often require the transfer of large amounts of tax revenues to the companies that, in many instances, could have been put to better use in other priority programs.

PERFORMANCE REQUIREMENTS

Most previous speakers in these hearings strongly urged the U.S. Government to use its position as the world's largest trading nation to work toward an international agreement to reduce the use of performance requirements. This is one of our top priorities. Host governments use performance requirements to ensure that incoming investment serves specific national objectives and needs. Frequently, they are linked to permission to enter the country or to receive investment incentives. Performance requirements may specify conditions for minimum employment and export levels, local value added or local content, or technology transfer. Trade-

related performance requirements are one of the most serious problems facing the international trading community today.

Generally, trade-related performance requirements relate to exports, value-added and local-content, or maximum import levels. Export performance requirements are commitments to export a given percentage or a specified minimum quantity of goods produced. Minimum export requirements have the effect of increasing supplies to world markets from a specific production source beyond the levels which pure market forces would dictate. Being fundamentally uneconomic, they result in a hidden subsidy by either the host country or foreign company. Local-content requirements stipulate that a given percentage of the value of the final output must be purchased or produced locally. Some of these provisions have the effect of import quotas which could be deemed prohibited under the GATT.

We have examples of such restrictive schemes in Mexico and Canada. In Mexico, the purpose of the Decree for Development of the Automotive Industry-scheduled to take full effect by 1982—is to accelerate the growth of the domestic auto industry and to generate foreign exchange. Its trade effects will mean reduced sales of U.S. auto parts in Mexico and increased sales of Mexican automobile parts in this country.

In Canada, the Cabinet reviews all incoming foreign investment and foreign takeovers and allows only those investments bringing "significant benefit" to Canada. Many of the foreign investors in Canada have made legally binding commitments regarding their exports or imports. We have been discussing this issue with the Canadians both bilaterally and multilaterally. In an effort to secure additional information on the specific nature of these commitments, the Commerce Department has sent a questionnaire to over 1000 firms.

INCIDENCE OF INVESTMENT INCENTIVES AND PERFORMANCE REQUIREMENTS

The use of investment incentives and performance requirements to achieve national economic goals is wide-spread among our major trading partners. This was one of the findings of our just-released analysis of incentives and disincentives based on the Benchmark Study of U.S. Direct Investment Abroad, 1977.[1] Under this effort, the Commerce Department questioned almost 24,000 U.S. non-bank affiliates of non-bank parents about their experiences with foreign government practices of granting investment incentives and levying performance requirements. It was the first Benchmark Survey that included information on such policies.

Our analysis showed that, on average, about one-quarter (26 percent) of all U.S. affiliates overseas had received one or more incentives to invest—mostly in the form of tax concessions (20 percent), and some in the form of tariff concessions (8 percent), subsidies (9 percent), or other incentives (5 percent). There was a wide range from country to country in the percentages of companies granted incentives. Ireland, for instance, had granted one or more incentives to more than two-thirds (70 percent) of affiliates of U.S. companies. South Korea was second with 53 percent and Hong Kong was the lowest with 5 percent. As for an industry analysis, incentives were most often granted to affiliates in the manufacturing sector, particularly those in the transportation equipment, food products, and electrical machinery industries (slightly over 40 percent on average). Affiliates in the mining sector were second (almost 30 percent).

With regard to performance requirements, the Survey showed that 14 percent of U.S. affiliates overseas were subject to one or more such requirements, including minimum export requirements (2 percent), maximum import levels (3 percent), minimum local input levels (3 percent), and minimum local labor content requirements (8 percent). The Survey also revealed that a much larger percentage of affiliates operating in developing countries had to comply with performance requirements than did those operating in the developed countries. Affiliates in the mining industry were most often subject to performance requirements (27 percent), followed by manufacturing affiliates (19 percent). A comparison of the frequency of both incentives and performance requirements showed that U.S. affiliates received investment incentives on average almost twice as often as they were limited by performance requirements (26 percent versus 14 percent). Developing countries subjected U.S. affiliates to performance requirements

[1] U.S. Department of Commerce, International Trade Administration, "The Use of Investment Incentives and Performance Requirements by Foreign Governments," October 1981.

only slightly more often than they granted incentives (29 percent versus 27 percent). Developed countries typically granted U.S. affiliates incentives far more often than they imposed performance requirements.

EXCEPTIONS TO NATIONAL TREATMENT

The principle of national treatment provides for equal treatment of domestic and foreign-owned affiliates by host countries. Exceptions to that principle, like performance requirements, constitute a significant impediment to foreign direct investment and—as previous testimony has shown—are of concern to the U.S. business community. The witnesses listed a large variety of practices, including local procurement practices and the selective use of government aids and subsidies to favor locally controlled enterprises and specific industries. Other departures frcm national treatment include discriminatory tax treatment, limitations on access to local capital markets, and screening of takeovers of, or mergers with, a locally owned firm. Other examples—although admittedly of less significance—are nationality and residency requirements for members of boards of directors of foreign-owned subsidiaries, and, in a few cases, of management of branches. Some nations also have exceptions to national treatment with respect to the initial investment, including restrictions on foreign ownership of land. Others have special requirements for licensing, managing, or operating foreign-controlled companies in the service sector, including banks, insurance companies, real estate companies, brokerage houses, or public accounting firms. The Commerce Department's Office of International Services is working to reduce discrimination in these areas and to establish internationally accepted rules for the treatment of services operations, including those involving investment. The service industry is, at present, a major U.S. balance of payments earner and its potential in the eighties is even greater.

Mr. Chairman, the promotion and maintenance of an open international investment system is of vital importance to us all. We must make every effort to deal with measures that distort the free flow of investment. We must continue to seek broad international acceptance of the principle of national treatment and greater discipline over the use of investment incentives and performance requirements. We must learn from the experiences of the early 1930's that nationalistic actions may offer solutions in the short run that can have serious negative effects on long-term goals and interests.

U.S. GOVERNMENT ACTIONS

May I now say a few words about what we are doing at present and what we can do in the future to improve the efficiency and openness of the international investment system. We have pursued, and we will continue to pursue, multilateral, bilateral, and unilateral approaches.

MULTILATERAL EFFORTS

The United States has played a leading and perhaps exclusive role in focusing international attention on the disruptive influence of investment incentives and disincentives. We have initiated and fostered investigation of these issues in the OECD, the United Nations (UN), and the World Bank's Joint Development Committee, and under the General Agreement on Tariffs and Trade (GATT). These studies may lead to mutual understandings and perhaps formal commitments on such investment matters.

OECD

Based on the 1976 Investment Declaration and Decisions, we are working in the OECD toward a deeper commitment by member countries to reduce the use of investment incentives and performance requirements and to strengthen and expand the national treatment principle. Initiated at the behest of the United States, progress on such programs has been extremely slow. Earlier this month, the United States launched another broad initiative in various OECD bodies to "reenergize" that work. We also proposed that the OECD agree to steps that might be taken to reduce obstacles to private investment flows in non-OECD countries and on ways to increase private investment flows to the developing world. The initial reaction has been favorable but specifics of the program remain to be worked out. We are pleased with the response within the OECD and are hopeful that our efforts OECD work on these priority concerns.

GATT

We have proposed work on trade-related performance requirements in the GATT, where the membership consists of both developed and developing nations. The time has come to include some of the newly industrialized nations of the Third World in international discussions aimed at creating more favorable conditions for both investment and trade. We believe the GATT is well suited to develop an effective understanding on performance requirements since it has already adopted enforceable rules on minimum export levels in its subsidy code. We also plan to request that the performance requirement issue be put on the agenda of next year's GATT Ministerial meeting. This will test whether existing GATT tools are adequate or whether a new set of ground-rules must be fashioned.

IBRD/IMF (INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT/INTERNATIONAL MONETARY FUND) JOINT DEVELOPMENT COMMITTEE

A 1980 report of the Development Committee's Special Investment Taskforce found that incentives are harmful to the investment process and should be curbed, if not eliminated. Accordingly, the International Finance Corporation (IFC) of the World Bank Group has been asked to prepare a major study on the issue of both incentives and performance requirements. We welcome this initiative.

INTERNATIONAL CODES

We have also participated actively in the preparation of other international codes of conduct or guidelines relating to multinational corporations (MNCs). We believe that if properly conceived and drafted guidelines setting forth standards of good behavior for both MNCs and governments can make an important contribution to decreasing mistrust and conflict in investment matters. In negotiating these codes, we seek to ensure that the interests of U.S. companies are properly protected.

Codes for multinational corporate and host government behavior have been completed and are now being implemented by the OECD and the International Labor Organization (ILO). In contrast, progress on a U.N. general code that would have worldwide application is very slow, and some of the most crucial issues, including those on nationalization and compensation, are still unresolved. We believe that the code must strike a balance between company and government obligations and apply to all enterprises regardless of the nature of their ownership. Similarly, negotiations on a U.N. code relating to the transfer of technology have reached an impasse, and the issue awaits consideration by the U.N. General Assembly.

BILATERAL EFFORTS

We are continuing to work with foreign governments on bilateral agreements. High-level consultations have recently been held with several countries whose investment policies have been particularly troublesome to the United States. For example, we have discussed the adverse effects on U.S. trade of the proposed Mexican Decree for Development of the Automotive Industry, and consultations have been held with Canada on their National Energy Program and their investment screening policies.

Tax treaties and bilateral investment treaties also affect international investment relations. We now have tax treaties with 35 countries, but most of them are with developed countries and many fail to cover adequately significant issues which have a bearing on U.S. foreign investment. We need to see if future tax treaty negotiations can cover more investment questions than they have in the past.

We are encouraged by the strong recommendation by one witness that the U.S. Government vigorously pursue its program of negotiating Bilateral Investment Treaties (BITs) with developing countries as a way to facilitate more U.S. private investment in these countries. Such treaties would provide, among other things, for broad rights of establishment, national treatment of investors, equitable resolution of disputes, and safeguards for capital and earnings repatriation.

The Administration will soon submit a draft Bilateral Investment Treaty to Egypt. Once concluded, the agreement could serve as a model for treaties between the United States and other countries. We agree with the comments of other witnesses underlining the desirability of BITs with such strategically important areas as the Caribbean Basin and Central America. The suggestion by one of the

witnesses that the Administration consider the possible inclusion in bilateral investment treaties of a set of provisions on investment incentives and performance requirements also merits further scrutiny.

UNILATERAL U.S. GOVERNMENT EFFORTS

Section 301 of the Trade Act of 1974

We can also take actions unilaterally. However, such actions will require extreme political and economic sensitivity since they may invite retaliation by affected nations. Under Section 301 of the Trade Act of 1974, the President can respond to any act, policy, or practice of a foreign country that: (a) violates the provisions of a trade agreement with the United States; or (b) denies benefits to the United States under such a treaty; or (c) is unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. trade. A bill introduced by Congressman Schulze (H.R. 4407) would clarify Section 301 to ensure that the President can retaliate on investment issues. The Administration, in its high-level review of U.S. international investment policy, is examining this possible clarification of Section 301. In this regard, however, I might note that there are legal and practical implications of specifically including investment issues in the Section 301 scheme.

OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

As the Subcommittee is aware, under recently enacted legislation, OPIC would be enjoined "to refuse to insure, reinsure, or finance any investment subject to performance requirements which would reduce substantially the positive trade benefits likely to accrue to the United States from the investment."

OTHER ISSUES

Investment disputes

Almost all previous witnesses have indicated the need for the U.S. Government to secure non-discriminatory treatment for U.S. investors abroad and to provide full support in case of expropriation. We understand those concerns and would like to reaffirm our strong belief that investors must be assured of treatment consistent with international law, including non-discriminatory treatment and prompt, adequate, and effective compensation in case of expropriation. We will not stand by idly while our companies investing abroad find their interest threatened by countries derogating from the principle of national and most-favored-nation treatment and from their responsibilities under international law. We encourage U.S. investors involved in expropriation disputes to initiate, as soon as possible, discussions with host governments and to collect all necessary information and documentation in support of their claims. To minimize the incidence of expropriation and to facilitate payment of prompt, adequate, and effective compensation, we also emphasize in our bilateral and multinational relations with other countries acceptance of specific standards for the treatment of foreign investors. This helps to protect U.S. investors overseas and to create a favorable investment climate that will attract investment to the host country.

In response to an expropriation by a foreign government, when appropriate steps are not being taken to compensate the investor, we can withhold a variety of economic benefits such as tariff concessions under the General System of Tariff Preferences, access to international lending authorities and U.S. aid. We have also included provisions relating to the expropriation of U.S. property and holdings in our model Bilateral Investment Treaty. Similarly, we seek to prevail upon international financial institutions, such as the World Bank Group, to incorporate the issue of expropriations in the conditions they prescribe for their lending operations.

We will continue to keep under active review all cases of actual and potential expropriation of U.S. property abroad and to press vigorously for fair treatment of our citizens in conformity with international law.

Foreign investment in the United States

I would now like to say a few words on foreign investment in the United States, a matter of concern in some quarters. Foreign investment in the United States has been rapidly growing and now exceeds $65 billion. Traditionally, U.S. restrictions on foreign investment have been minimal. However, recent actions by Canada to reduce foreign direct investment in the energy sector and the imposition by other nations of a plethora of conditions on foreign direct in-

vestment, combined with an increase in their own equity holdings in the United States, have led to calls on the U.S. Government to retaliate by limiting foreign investment in general or by restricting foreign direct investment from specific countries or in specific sectors.

We are closely watching developments and trends with respect to foreign investment in this country. The Committee on Foreign Investment in the United States (CFIUS) is responsible for monitoring the flow of such investments and for reviewing cases which might have major implications for U.S. national interests. The Commerce Department is a member of the CFIUS and of the recently established CCEA Task Force looking into our inward investment policy. Since its establishment, CFIUS has distinguished between private foreign investment and investment by government-controlled entities, to ensure that the latter do not enjoy special advantages over competitors in terms of taxation, information disclosure, and the like.

CONCLUSION

To sum up, the Department of Commerce supports the continuation of the U.S. Government's traditional posture of openness and neutrality toward international investment. We must, therefore, reverse the worldwide trend towards government intervention in the investment process and aggressively seek to dismantle, or at least minimize, barriers to international investment. Incentives, performance requirements, and exceptions to national treatment jeopardize the worldwide efficient use and distribution of international investment resources and the contributions multinational corporations *can* and *do* make to global economic growth and development. Together with other governments, we must work to develop international understandings and guidelines that would provide a basis for addressing and resolving problems that stand in the way of a more open global investment system. This is a difficult undertaking, but the beginning has been made and, we believe, we are on the right track.

Mr. Chairman, this concludes my remarks. I thank the Subcommittee for the opportunity to present the Commerce Department's views.

THE USE OF INVESTMENT INCENTIVES AND PERFORMANCE REQUIREMENTS BY FOREIGN GOVERNMENTS

Investment Policy Division
OFFICE OF INTERNATIONAL INVESTMENT
International Trade Administration
U.S. DEPARTMENT OF COMMERCE
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Preface

The following study of the worldwide use of incentives and performance requirements is based on data collected by the U.S. Department of Commerce Bureau of Economic Analysis (BEA) for its Benchmark Survey of U.S. Direct Investment Abroad - 1977. An investment incentive can generally be defined as a government action or policy which increases the net cash flow of an investment over what would have been anticipated without government intervention. Investment performance requirements are any requirements placed upon a foreign controlled enterprise by a host nation. The incidence of incentives and performance requirements is widespread and their impact upon international trade and investment is potentially significant.

The BEA 1977 Benchmark Survey is the first of BEA's benchmark surveys to include questions on these measures and, as a result, provides an opportunity to take an in-depth look at the use of incentives and performance requirements. Overall, the 1977 survey covered 3,540 U.S. parent companies and their 24,666 foreign affiliates. Since reporting was universally mandatory, reports from these companies and their affiliates cover virtually the entire universe of U.S. direct investment abroad. Of the total number of affiliates polled, information on the use of incentives and performance requirements by foreign governments was requested from the 23,641 U.S. non-bank affiliates on non-bank parents. The survey asked these affiliates whether they were granted incentives or had to accept performance requirements and, if so, asked them to identify which of the four major categories of each applied. An analysis of the results of these questions is the subject of this report.

This report was prepared by Charlotte A. Zakour, an international economist in the Investment Policy Division. The Office of International Investment welcomes comments on this publication. Requests for additional copies and comments should be addressed to:

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Summary of Highlights

The Benchmark Survey of U.S. Direct Investment Abroad - 1977, conducted by the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce, questioned 23,641 U.S. non-bank affiliates of non-bank parents about their experiences with foreign government practices of granting investment incentives and levying performance requirements. Following are the highlights of an analysis of the BEA data:

Investment Incentives

-- The 1977 Benchmark Survey found that on average 26 percent of U.S. affiliates overseas had received one or more incentives to invest.

-- Twenty (20) percent of all U.S. affiliates received tax concessions, 8 percent tariff concessions, 9 percent subsidies, and 5 percent other incentives.

-- An almost equal percentage of U.S. affiliates in developing countries and developed countries received incentives upon investing -- 27 percent and 25 percent, respectively.

-- There was a wide range from country to country in the percentages of companies granted incentives. Ireland, for example, granted one or more incentives to 70 percent of its U.S. affiliates. South Korea was second with 53 percent. The lowest was Hong Kong, granting incentives to only 5 percent of U.S. affiliates.

-- Affiliates in the manufacturing industry, particularly those in manufacturing transportation equipment, food products, and electrical machinery, most often received incentives, 41 percent on average. Affiliates in the mining industry were second at 29 percent.

-- Affiliates in the finance, insurance, and real estate industry received the least incentives -- 12 percent.

Performance Requirements

-- The survey found that on average 14 percent of U.S. affiliates overseas were subject to one or more performance requirements.

-- Two (2) percent of U.S. affiliates reported being subject to minimum export requirements and 3 percent to maximum import levels. Three (3) percent were required to utilize a minimum amount of inputs locally, and 8 percent were subject to a minimum local labor content requirement.

-- Six (6) percent of U.S. affiliates reported that their U.S. parents had to limit the proportion of equity held in the affiliate.

-- A much larger percentage of U.S. affiliates in developing countries were subject to performance requirements than in developed countries -- 29 percent versus 6 percent. All South American countries except Argentina subjected at least one third of U.S. affiliates to these requirements. India's percentage was the highest in Asia and worldwide -- 60 percent. Only Hong Kong and Singapore were relatively low at 2 percent and 11 percent, respectively. In the developed countries, Portugal and Turkey most often imposed performance requirements on U.S. affiliates -- in 37 percent of the cases.

-- Affiliates in the mining industry were most often subject to performance requirements -- 27 percent on average.

-- Manufacturing affiliates were second with 19 percent subject to performance requirements. Within this group, affiliates manufacturing transportation equipment were affected as often as those in mining equipment manufacturing -- in 27 percent of the cases.

Comparison of the Frequency of Both Incentives and Performance Requirements

-- U.S. affiliates received investment incentives from host countries on average almost twice as often as they were restricted by performance requirements (26 percent versus 14 percent).

-- Developing countries on average subjected U.S. affiliates to performance requirements only slightly more often than they granted incentives, 29 percent and 27 percent, respectively.

-- Almost all developed countries granted U.S. affiliates incentives far more often then they imposed performance requirements -- on average 25 percent and 6 percent, respectively.

-- U.S. affiliates in the mining industry were subject to performance requirements 27 percent of the time while being granted incentives slightly more often -- in 29 percent of the cases.

-- U.S. manufacturing affiliates were granted incentives far more often than they were restricted by performance requirements, 41 percent versus 19 percent.

Investment Incentives

Introduction

An investment incentive can generally be defined as a government action or policy which increases the net cash flow of an investment over what would have been anticipated without the government intervention. Incentives take a wide variety of forms and can apply across the board to all investments or to particular industry sectors and geographic areas, or can be tailored to specific projects on a case by case basis.

Investment incentives may cause changes in international investment and trade patterns by shifting the location of investments from one region or country into some other region or country. In addition, conditions of normal competition may be adversely affected because companies receiving such incentives can displace production in third country markets, as well as home country markets, through exports from the subsidized facilities.

The 1977 Benchmark Survey polled 23,641 U.S. non-bank affiliates of non-bank parents to determine what incentives they received from foreign national governments at the time of their foreign investment. Three major incentives were reported (tax concessions, tariff concessions and subsidies) while "all others" was a fourth category. Of all the affiliates surveyed, 6041 or 26 percent responded that they had received at least one incentive. Twenty percent of the affiliates received tax concessions, 8 percent tariff concessions, 9 percent subsidies, and 5 percent other incentives (see Table 1 on next page). Three percent of the population failed to respond to any of the four questions on incentives by type.

Of the 4686 affiliates reported receiving tax concessions, 21 percent of these stated that the incentive was available to foreign-owned companies only. Likewise, 8 percent were given tariff concessions, of which 20 percent were available to foreign investors only. Nine percent of the affiliates reported receiving subsidies to invest, 19 percent of which were for foreign investors only. Five percent of the population received other incentives. Sixteen percent of these were reported to be available only to foreign investors.

Incentives By Area

An almost equal percentage of foreign affiliates in developing countries (27 percent) and developed countries (25 percent) received investment incentives -- mostly in the form of tax and tariff concessions. Twenty two percent of U.S. affiliates in developing countries received tax incentives versus 19 percent in developed countries, while tariff concessions were granted 14 percent of U.S.

TABLE 1

Incidence of Incentives By Type and Area

	Total # of affiliates	Total of at least one	Tax concessions	Tariff concessions	Subsidies	Other Incentives
TOTAL	23,641	6041 (26%)	4686 (20%)	1926 (8%)	2053 (9%)	1195 (5%)
Number of those receiving incentives available to foreign-owned* companies only						
			1001 (21%)	382 (20%)	389 (19%)	191 (16%)
DEVELOPED	15,603 (66% of all affiliates in developed countries)	3922 (25%)	2986 (19%)	840 (5%)	1691 (11%)	807 (5%)
Number of those receiving incentives available to foreign-owned companies only						
			585 (20%)	130 (16%)	337 (20%)	125 (16%)
DEVELOPING	7,627	2081 (27%)	1664 (22%)	1086 (14%)	359 (5%)	382 (5%)
Number of those receiving incentives available to foreign-owned companies only						
			403 (24%)	252 (23%)	52 (15%)	63 (17%)

*BEA Questionnaire did not specify definition of "foreign-owned " but it is assumed to represent equity of 10% or more.

Source: Calculations based on data from:1) U.S. Direct Investment Abroad, 1977, U.S. Dept. of Commerce, Bureau of Economic Analysis, International Investment Division; and 2) a special tabulation of data gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977,provided by the International Investment Division.

affiliates in developing countries and 5 percent in the developed. The opposite was true for subsidies -- 11 percent for developed country affiliates and 5 percent for developing countries. Other incentives were matched at 5 percent for both.

The same area pattern exists for the percentages of incentives available to foreign-owned companies only. The percentages for tax and tariff concessions for affiliates in developing countries were 24 percent and 23 percent, respectively, and 20 percent and 16 percent for those in developed countries. Twenty percent of the developed country affiliates that reported receiving subsidies said they were granted to foreign investors only, while the developing area figure was 15 percent. For "other incentives," developed and developing areas were roughly equivalent at 16 percent and 17 percent.

There was a wide range from country to country in the percentages of companies granted incentives. Ireland, for example, granted one or more incentives to 70 percent of its U.S. affiliates. South Korea was second with 53 percent. Israel was next at 41 percent with Taiwan and Brazil close at 40 percent. A large number of countries granted between 30 percent and 40 percent of U.S. affiliates one or more incentives. This group consists of Luxembourg, United Kingdom, Greece, Spain, Sweden, Australia, New Zealand, South Africa, Argentina, Peru, Venezuela, India, Indonesia, and Malaysia. The lowest was Hong Kong, granting incentives to only 5 percent of U.S. affiliates. Likewise, Japan granted only a small percent -- 9 percent. Canada was relatively low at 19 percent, while a sizable number of countries were roughly consistent with the overall average of 26 percent.

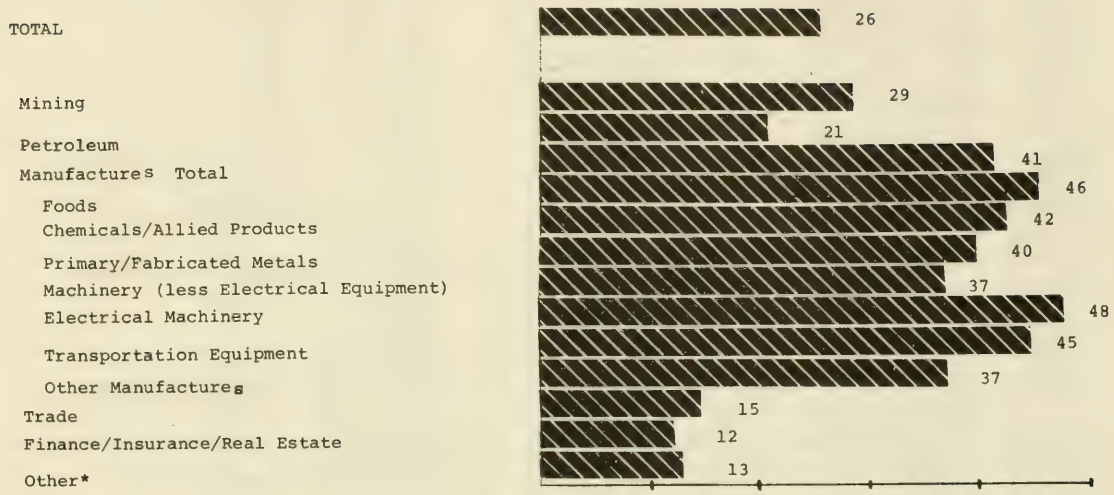
Incentives by Industry

Affiliates in the manufacturing industry most often received incentives. On average, 41 percent of the surveyed companies engaged in manufacturing received at least one investment incentive. In particular, affiliates engaged in manufacturing transportation equipment, food products, and electrical machinery most often received incentives, 45 percent, 46 percent, and 48 percent of the time, respectively.

Twenty-nine percent of mining affiliates received incentives with petroleum affiliates next at 21 percent. The average for all other industries was about 13 percent. Chart 1 on the next page shows this concentration of incentives by industry.

CHART 1

Concentration of Incentives by Industry
Percent of Total Affiliates



*Other: Agriculture, Forestry, Fishing, Construction, Transportation, Communications, Public Utilities, Services

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce' Bureau of Economic Analysis.

Performance Requirements

Introduction

In addition to questions regarding incentives, the 1977 Benchmark Survey polled affiliates to determine if they were subject to performance requirements. Investment performance requirements are any requirements placed upon a foreign controlled enterprise by a host nation. The requirements may be conditions under which various investment incentives are provided or may be conditions for foreign investors to attain entry to a country. They are considered an economic detriment to the extent that they create economic behavior inconsistent with market-dictated forces. In particular, trade-related performance requirements can lead to distortions in trade and investment flows and in the uneconomic use of resources. For example, local content requirements mandate the use of domestic factors of production irrespective of relative costs. Similarly, export requirements force a firm to export a certain amount of its production, irrespective of comparative advantage. Such exports can cause trade diversion through displacement of another country's exports to third country markets or through increased imports in another country from the firm complying with the export requirements. Possible losses incurred in such exports can be made up by exploiting what are often monopoly-like positions in the host country. These requirements have effects similar to trade protection or subsidies in altering international trade flows and adversely affecting other countries. Trade distortion is most severe when two or more requirements are used in conjunction with each other (e.g., local content and export requirements in the same industry) or when they are used in conjunction with other restrictive measures (e.g., tariffs) or incentives.

Four major performance requirements were reported in the Benchmark Survey. These were minimum export requirements, maximum import limitations, minimum local input requirements, and minimum local labor content requirements. Of the 23,641 affiliates surveyed, 3240, or 14 percent, stated that they were subject to at least one performance requirement (see Table 2 on next page). Four percent of the population failed to respond to any of the four questions on performance requirements by type. Only 2 percent reported that they were subject to minimum export requirements, and 37 percent of these said the requirements were imposed on foreign investors only. Three percent of the reporters were subject to maximum import levels, with 21 percent of this group reporting that only foreign investors were so constrained. Again, 3 percent of the affiliates were required to utilize a minimum local content. About one-fourth of these reported that the requirement was for foreign investors only. The most commonly reported performance requirement was the use of a minimum amount of local labor. Eight percent of the group reported this requirement, and, of these, 28 percent stated that the requirement was made of foreign investors only.

TABLE 2

Incidence of Performance Requirements by Type and Area

Total no. of affiliates	Total of at least one	Export a minimum amount	Import no more than certain amt.	Acquire minimum local cont.	Minimum local labor	No. U.S. parents required to limit equity in affiliates
Total: 23641	3240 (14%)	356 (2%)	582 (3%)	593 (3%)	1885 (8%)	1349 (6%)
Number of those subject to performance requirements imposed upon foreign-owned* companies only						
		132 (37%)	121 (21%)	145 (24%)	529 (28%)	
Developed: 15603	1008 (6%)	130 (1%)	169 (1%)	154 (1%)	493 (3%)	374 (2%)
Number of those subject to performance requirements imposed upon foreign-owned companies only						
		54 (42%)	28 (17%)	42 (27%)	120 (24%)	
Developing: 7627	2217 (29%)	226 (3%)	(D)	(D)	1384 (2%)	968 (13%)
Number of those subject to performance requirements imposed upon foreign-owned companies only						
		78 (35%)	(D)	(D)	(D)	

* BEA questionnaire did not specify definition of "foreign-owned," but it is assumed to represent equity of 10% or more.

Source: Calculations based on data from: 1) U.S. Direct Investment Abroad,1977, U.S. Department of Commerce,Bureau of Economic Analysis, International Investment Division; and 2) a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division.

Additionally, the 1977 Benchmark Survey asked affiliates whether their U.S. parents were subject to maximum equity levels in the affiliates. Only 6 percent responded yes while 4 percent made no response. This was more often evident in developing countries where 13 percent of U.S. affiliates reported that their U.S. parents had equity limitations. Only 2 percent of affiliates in developed countries reported that their U.S. parents were subject to equity limitations in their affiliates.

Performance Requirements by Area

A larger percentage of U.S. affiliates in developing countries were subject to performance requirements on average than in developed countries -- 29 percent versus 6 percent. Little information is available however, by type of requirement, due to suppression of most of the data. But, developing country affiliates did report that 3 percent were subject to minimum export requirements, while 1 percent of developed country affiiates reported such a requirement. Of the 3 percent for developing countries, 35 percent stated this was a requirement for foreign investors only. Forty-two percent of developed country affiliates subject to minimum export requirements reported the same. One percent of developed country reporters were subject to maximum import limitations, of which 17 percent noted that it was a regulation for foreign investors only. Also, one percent of developed country reporters were subject to minimum local content requirements, and 3 percent were required to use a minimum amount of local labor. Approximately 1/4 of both of these reporting groups stated these requirements applied only to foreign investors. The only remaining information on developing country affiliates is that 2 percent reported being subject to minimum local labor content requirements.

A sizable number of developing countries imposed performance requirements upon U.S. affiliates. All South American countries except Argentina subjected at least 1/3 of U.S. affiliates to these requirements. Peru and Venezuela gave such treatment to at least 1/2. Mexico's percentage was 41 percent. In Africa, Egypt, Libya and Nigeria had requirements in 1/3 to 1/2 of the cases. India's percentage was the highest in Asia and worldwide -- 60 percent. Indonesia, Malaysia, and the Philippines were between 27 percent and 33 percent, while South Korea was higher at 40 percent. Only Hong Kong and Singapore were relatively low at 2 percent and 11 percent, respectively. In the developed countries, Portugal and Turkey most often imposed performance requirements on U.S. affiliates -- in 37 percent of the cases. Ireland, New Zealand, and Greece were all close to 20 percent.

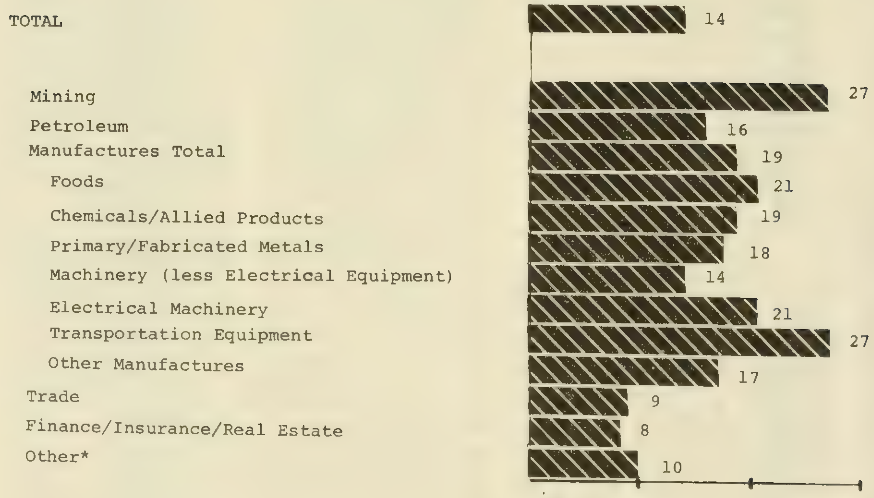
Performance Requirements by Industry

U.S. affiliates in the mining industry were most often subject to performance requirements. Of the mining affiliates surveyed, 27 percent reported such constraints to investment. Manufacturing was

next, with 19 percent of all these concerns subject to performance requirements. Within this group, affiliates manufacturing transportation equipment were most often affected -- 27 percent of the time. Electrical machinery and manufactured foods were next at 21 percent. Performance requirements were levied on 16 percent of the petroleum industry concerns surveyed. The average for all other industries (Trade, Finance/Investment/Real Estate, and Other) was 9 percent. Chart 2 on the next page shows the concentration of performance requirements by industry.

CHART 2

Concentration of Performance Requirements by Industry
Percent of Total Affiliates



*Other: Agriculture, Forestry, Fishing, Construction, Transportation, Communications, Public Utilities, Services

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce' Bureau of Economic Analysis.

Comparison of the Frequency of both Incentives and Performance Requirements

The 1977 Benchmark Survey found that 26 percent of its respondents were granted one or more incentives by host countries and that 14 percent were subject to one or more performance requirements. A number of interesting points appear when incentives and performance requirements are looked at together, both by area and by industry.

Incentives and Performance Requirements by Area

A comparison of developed and developing countries shows that the developing areas on average subjected U.S. affiliates to performance requirements far more often than did the developed countries -- in 29 percent of the cases versus 6 percent -- while they granted incentives about as often -- 27 percent versus 25 percent of the time. Almost all the developed countries granted U.S. affiliates incentives far more often than they imposed performance requirements. The only exceptions to this were Portugal, Turkey, and Japan. In Japan's case, the percentage of affiliates receiving incentives was equal to that of affiliates subject to performance requirements -- 9 percent for both. The situation was mixed in the developing countries where performance requirements existed far more often than incentives in about one third of the countries. The most significant of these were Peru, Venezuela, Mexico, Libya, Nigeria, and India (see Table 3 on next page).

Table 4 (immediately following Table 3) gives a list of developing countries where incentives number far more than performance requirements. However, in some of these cases, the incidence of performance requirements was high as well. This is especially true of South Korea. Overall, it would appear that the most attractive countries for investment would likely be those which grant low to moderate incentives and impose few performance requirements. This combination is exhibited by the countries listed in Table 5 (immediately following Table 4). (NOTE: Canada is listed as having few performance requirements because in 1977 the bulk of U.S. companies had already invested there before the Foreign Investment Review Agency (FIRA), which screens foreign investment, achieved its present level of activities.)

Incentives and Performance Requirements by Industry

U.S. mining industry affiliates were most often subject to performance requirements -- 27 percent of the time -- while being granted incentives just slightly more often --29 percent. U.S. manufacturing affiliates were granted more incentives, by far, than other industries -- 41 percent of the time -- and on average were subject to performance requirements 19 percent of the time. However, within the manufacturing industry, affiliates manufacturing transportation equipment were affected by performance requirements as often as those in the mining industry -- 27 percent. Affiliates manufacturing other products were somewhat less limited by

TABLE 3

Comparison of Frequency of Incentives Granted to and Performance Requirements Imposed on U.S. Affiliates by Host Country Where Performance Requirements Frequency is Larger

Country	Percent of U.S. Affiliates Receiving Incentives	Percent of U.S. Affiliates Subject to Performance Requirements
Portugal	23	37
Turkey	26	37
Peru	34	50
Venezuela	33	52
Mexico	28	41
Libya	12	58
Nigeria	21	52
India	35	60

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce' Bureau of Economic Analysis.

TABLE 4

Developing Countries Granting Incentives to U.S. Affiliates Far More Often Than Imposing Performance Requirements

Country	Percent of U.S. Affiliates Receiving Incentives	Percent of U.S. Affiliates Subject to Performance Requirements
Argentina	31	13
Bermuda	19	4
Netherlands Antilles	21	5
Israel	41	22
Singapore	24	11
South Korea	53	40
Taiwan	40	18

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce Bureau of Economic Analysis.

TABLE 5

Concentration of Low to Moderate Incentives and Low Performance Requirements

Country	Percent of U.S. Affiliates Receiving Incentives	Percent of U.S. Affiliates Subject to Performance Requirements
* Canada	19	4
* Belgium	26	7
Denmark	28	2
* France	18	7
* Germany	20	2
* Italy	29	6
Luxembourg	38	1
* Netherlands	29	2
* United Kingdom	32	3
Austria	25	4
Norway	11	7
Sweden	33	3
* Switzerland	12	7
* Japan	9	9
* Australia	37	8
South Africa	35	12
Argentina	31	13
Panama	21	15
Bahamas	16	10
** Bermuda	19	4
Netherlands Antilles	21	5
Liberia	21	15
Hong Kong	5	2
Singapore	24	11

* Countries are 10 of top 12 countries with the largest stock of U.S. foreign direct investment at yearend 1977. Only Brazil and Mexico of the top 12 are absent.

** Data for Bermuda was not disclosed for 1977. However, 1976 and 1978 U.S. direct investment position data indicate that for 1977, Bermuda would most likely place in the top 12 recipients of U.S. foreign direct investment.

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce' Bureau of Economic Analysis.

performance requirements but received fewer incentives by about the same proportion. Petroleum affiliates trailed both mining and manufacturing on both percentages of incentives and performance requirements, 21 percent and 16 percent, respectively. The industries least affected by both were Trade, Finance-Investment-Real Estate, and Other as defined in Table 6 below (see Table 6 on next page for summary of information).

TABLE 6

Incentives and Performance Requirements by Industry

Industry	Percent of U.S. Affiliates Receiving Incentives	Percent of U.S. Affiliates Subject to Performance Requirements
TOTAL	26	14
Mining	29	27
Petroleum	21	16
Manufacturing	41	19
Food Products	46	21
Chemicals & Allied Products	42	19
Prim. & Fab.Metals	40	18
Machinery (excl.Elect.)	37	14
Electrical Machinery	48	21
Transp. Equipment	45	27
Other	37	17
Trade	15	9
Finance,Insurance, Real Estate	12	8
Other*	13	10

* Agriculture, Forestry, Fishing, Construction, Transportation, Communications, Public Utilities, Services

Source: Calculations based on a special tabulation of data, gathered through the BE-10 Benchmark Survey of U.S. Direct Investment Abroad-1977, provided by the International Investment Division of the U.S. Department of Commerce' Bureau of Economic Analysis.

Conclusion

By industry, the survey data shows a direct positive correlation between incentives and performance requirements. However, a country analysis shows two important facts: 1) developed countries offer incentives far more often than they impose performance requirements, and 2) for the developing countries, some grant incentives more often than they impose performance requirements, and others do the reverse. Thus, it appears that the policy on incentives and performance requirements is a function of two variables -- country investment policy and industrial policy. Together these can result in numerous combinations with varying magnitudes of both incentives and performance requirements which can cause from small to very large effects on investment and trade. Even if incentives are high, an equally high incidence of performance requirements can act as a significant deterrent to investment.

There are exceptions to this, however. In some cases, where performance requirements have only been imposed in significant numbers in the last several years, countries may notice at most merely a slowing in the amount of incoming investment, especially if they received the bulk of their foreign investments long ago. Countries like Brazil, Mexico, and Canada may believe, rightly or wrongly, that the benefits of being more selective outweigh the costs. For other countries with smaller stocks of foreign investment, imposing performance requirements without offering adequate incentives may be self-defeating. In any event, it is clear that investment is most concentrated in countries where low to moderate incentives are granted in combination with few performance requirements.

The CHAIRMAN. Thank you, Mr. Waldmann.

Now I am confused as to which alphabetization we should follow.

Mr. HORMATS. Go ahead.

STATEMENT OF MARC E. LELAND, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. LELAND. I will be very brief, Mr. Chairman. I have submitted a statement for the record. Rather than read it I will give you an overview of the statement.

The CHAIRMAN. Your full statement will be included in the record.

Mr. LELAND. Thank you. I welcome this opportunity to appear before you today on the subject of international investment. The U.S. policy toward investment, is basically an open market policy as you noted, but it is still to some degree in flux. We are looking at it. There are several groups, to which my statement refers, which are presently looking into what our policy should be.

The initial part of the statement deals with the importance of investment both inward and outward to U.S. trade and business. As you are aware, the longstanding and fundamental policy of the United States toward international investment has been to advocate an open and market-oriented approach. That policy continues and will continue throughout this administration and, we hope, well into the future.

However, we realize that there are several things that have to be looked at in order to maintain this open economy; and at the moment we are doing, throughout the Government, several reviews. Because of the growing importance of international investment to our economy, the CCEA, the Cabinet Council on Economic Affairs, has been looking at problems which have been arising in regard to investment.

They include national practices relating to foreign investment, such as performance requirements and investment incentives, and the potential implications of Government-controlled investment in the United States. The latter has been increasing. This includes not just what has been characterized as "the OPEC problem," but investments from France and other areas that are interested in making government purchases.

In light of this, we are looking into possible changes in the mandate of the Committee on Foreign Investment in the United States [CFIUS], and, of course, the review of the potential impact on U.S. Interests of the French nationalization program. We are also raising these issues in other fora multilaterally in the OECD, the IMF, and the GATT.

We are also in coordination with other agencies, the STR, Commerce, and State, holding bilateral consultations on these issues. This issue is constantly coming up; that is, the problem of what one is doing to distort trade by mechanisms that are used regarding investment.

Likewise, we have our own internal policies toward trying to help the free flow of investment. These include OPIC our methods of taxing foreign-source income, the examination of the efficacy of the Foreign Corrupt Practices Act, and attempts to assist developing countries by helping them have policies that will promote foreign investment in those countries.

The committee asked also for a comment on our policy relating to Canada. This has been dealt with somewhat by other speakers. We are now carrying on discussions with the Canadians regarding our concerns about the Foreign Investment Review Agency [FIRA] and the National Energy Program [NEP]. The Canadian Government itself is reviewing the FIRA.

We are hopeful that these consultations may bring some results. If not, there are international procedures we may resort to, but, hopefully, we will not have to do that. But I assure you, it is an ongoing review.

I'd like to summarize by saying that we believe an open-market approach to foreign investment is the best policy. However, we recognize the fact that certain actions may need to be taken by the U.S. Government to assure that everyone else follows that policy. We have to press for some discipline internationally in the use of measures to restrict or manipulate international investment flows.

We are now developing through, such as this book on performance requirements which Commerce has just prepared, more information on the impact these foreign policies are having on international investment and our economy.

Thank you.

[Mr. Leland's prepared statement follows:]

Prepared Statement of Marc E. Leland

I welcome this opportunity to discuss United States' policies toward international investment, both with regard to our investments abroad and foreign investments in the United States. I have read with interest the testimony presented by other witnesses who appeared before the subcommittee in July; and will comment, as the subcommittee requested, on the views and recommendations presented in that testimony. My testimony includes, as the subcommittee also requested, a discussion of Canadian investment policies and the Administration's plans regarding U.S. private investment in developing countries.

The Administration's Perspective on International Investment

International investment is an important and growing component of our economy, and our policies relating to international investment are therefore of great importance. This view is not unique, as previous testimony before the Subcommittee demonstrates. Nor is it confined to the United States. Foreign governments in developed and developing countries have been intervening to an increased degree to influence or manipulate foreign direct investment in their countries.

Foreign direct investment in the United States is viewed by this Administration as a welcome and substantial complement to domestic investment and like increased domestic investment will certainly help us revitalize our economy. Although foreign direct investment in the United States is small relative to our total economy, $65 billion versus a GNP exceeding $2 trillion, it has grown rapidly in recent years. And as it has grown it has provided new jobs to our economy, introduced new technology, strengthened our capital markets, and lowered the cost of capital to U.S. corporations, thus encouraging domestic investment.

Our own investments abroad, which totalled over $213 billion at the end of 1980, are coincidentally an important positive element in the United States balance of payments. In 1980, United States investment income on direct investment abroad was $37 billion. Also much of our international trade is associated with these investments. A recent Department of Commerce survey reveals that in 1977 $40.8 billion of U.S. exports, a third of our total exports, was shipped to foreign affiliates of United States corporations and $41.5 billion of United States imports was shipped from those affiliates.

The United States, therefore, has a particular interest in maintaining and promoting an open international investment system.

U.S. GOVERNMENT POLICY

As you are aware the long-standing and fundamental policy of the U.S. toward international investment has been to advocate an open, market-oriented approach. We welcome foreign investment in our country on a non-discriminatory basis. We adopted this approach to foreign investment here, not to accommodate foreigners or foreign governments, but because foreign investment provides substantial benefits to the United States.

The United States has also worked internationally to develop better discipline on the use of restrictive investment policies by other countries. A reduction in these foreign government restrictions to international investment, as previous witnesses to this subcommittee indicated, would lead to an expansion of our already substantial investments abroad and a coincidental increase in the benefits to the United States from those investments. It would also promote a more efficient flow of capital internationally.

ADMINISTRATION ACTIONS

In our opinion this fundamental open, market-oriented approach to international investment is still in the best interests of the United States and the world economy.

CCEA WORKING GROUP

However, because of the growing importance of international investment to our economy, and because other governments have adopted policies contrary to our own which threaten the international system, this Administration has begun a review of our international investment policy, both with regard to foreign investments in the United States and our own investments abroad. That review is being conducted under the auspices of the Cabinet Council on Economic Affairs (CCEA) by a Working Group on U.S. International Investment Policy, which I chair. Specific issues the working group is now preparing analyses of include: (1) National practices and policies relating to foreign investment, including information on performance requirements and investment incentives; (2) the potential implications of government-controlled investment in the United States; (3) possible changes to the mandate of the Committee on Foreign Investment in the United States; and (4) a review of the potential impact on U.S. interests of the French nationalization program.

The United States Government is at the same time taking actions in various areas now in an attempt to resolve outstanding investment issues.

MULTILATERAL INITIATIVES

The United States Government, for a number of years, has been pressuring other governments to focus on restrictive investment policies and how they distort subsequent trade flows. Our ultimate ob ective has been to develop through these efforts some international discipline on the use of restrictive investment practices.

While there has been some progress we are not satisfied with these multilateral efforts, and believe that the work of various international institutions on these issues must move forward. We have therefore either requested or plan to request new or strengthened initiatives in the following institutions.

The OECD

The United States Government has taken the lead in pressing the Committees on Investment and Multilateral Enterprises (CIME) and Capital Movements and Invisibles Transactions (CMIT) to analyze investment incentives and performance requirements. At a meeting of the OECD Executive Committee in Special Session (XCSS) the USG emphasized the importance we attach to investment and requested that the OECD begin a renewed effort to analyze performance requirements and investment incentives.

The IMF/World Bank

The USG chaired a Task Force of the Joint Development Committee which reviewed the relation of private investment flows to incentives and to performance requirements imposed on their investments and suggested that further analysis of this issue be conducted. The United States Government strongly supported further study and we understand the International Finance Corporation (IFC) at the Bank will begin in the next few months a study of the impact of investment incentives and performance requirements on investment and trade flows.

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In the GATT

The USG has already proposed that the GATT begin to focus on trade-related performance requirements. In our opinion the GATT subsidy code and the GATT rules prohibiting government intervention in trade can be interpreted to provide increased protection for investment. We also plan to use the 1982 GATT ministerial as an opportunity to press for action on these issues.

BILATERAL INITIATIVES

At the same time that we are pursuing these multilateral initiatives, the USG is also taking every opportunity to address these issues through bilateral consultations and other bilateral vehicles.

Consultations

The USG has initiated numerous bilateral consultations with our trading and investment partners to express our concerns regarding their use of restrictive investment policies which are detrimental to our interests and to the international system generally. As the Committee is aware, we have had and will continue to have discussions with the Government of Canada regarding its National Energy Program (NEP) and its Foreign Investment Review Agency (FIRA). Most recently we initiated similar consultations with the governments of France and Mexico regarding their investment policies.

Bilateral investment treaties (BIT's)

The Administration is also in the final stages of work on a Bilateral Investment Treaty which we hope will serve as the model for a series of BIT negotiations with receptive developing countries. These BITs should establish certain guidelines for treatment of new and established investment, dispute settlement, and expropriation or naturalization, thereby enhancing the investment climate for both U.S. investors and host countries.

UNILATERAL INITIATIVES

We have also taken a number of unilateral actions to remove impediments to U.S. firms investing abroad.

OPIC

On October 16, 1981, President Reagan signed legislation developed by the Administration and the Congress to extend OPIC's authority through September 1985. That legislation expanded the scope of OPIC's operation to include middle income developing countries, gave OPIC the authority to offer new civil strife coverage, and gave OPIC a trade mandate. We expect that this new and expanded authority will greatly increase the opportunity for U.S. investments in less developed countries.

Taxation of foreign source income

Congress has passed legislation as part of the tax package which greatly improves treatment of foreign sourced personal income. Past tax provisions imposed a burden on U.S. firms with operations abroad and placed them at a disadvantage relative to their foreign competitors.

Foreign Corrupt Practices Act (FCPA)

We have also supported amendments to clarify and reduce the export disincentive effect of the Foreign Corrupt Practices Act.

ACTIONS ON DEVELOPING COUNTRY INVESTMENTS

In addition to our initiatives on BITs, foreign source income, the FCPA, and our bilateral consultations, we have also been investigating ways by which we can facilitate the flow of U.S. private investment to developing countries to the mutual benefits of these countries and U.S. investors. Within this broad context, and more narrowly within the context of certain regions such as the Caribbean Basin we are analyzing the possibility of co-financing and multilateral insurance schemes to facilitate and protect investment to developing countries. However, our basic position, which was reflected at the Cancun Summit, is that actions by host countries to enhance their own investment climate is perhaps the most important and necessary policy change. Specifically we believe government actions in these countries to remove barriers to and conditions on new foreign

investment as well as to provide fair and equitable treatment of established foreign investments constitute a critical pre-condition to increasing foreign investment flows into developing countries.

POTENTIAL POLICY RESPONSES

While I support a continuation of the actions taken by the USG in these various fora, previous witnesses to the Subcommittee raised some serious concerns regarding the effectiveness of these actions. The United States Government will have to address these concerns. These concerns are exemplified by, but certainly not confined to, our current discussions with the Government of Canada regarding its NEP and FIRA policies. We believe that measures instituted by the Canadian Government are indicative of a general trend for governments to intervene in trade and investment flows by applying restrictive and discriminatory requirements such as performance requirements and investment incentives.

Although the United States and Canada have developed strong trade and investment relations, there are significant differences in our governments' approaches to economic questions. These differences in approach are the underlying cause of the conflict in our economic relations.

The U.S. Government has traditionally maintained a free market approach to trade and investment flows, and this Administration is committed to maintaining free markets as a central element of our domestic economic program. The Trudeau Government and other governments advocate a much more interventionist approach to economic issues.

We do not object to Canada's or any other government's desire to nationalize its economy. Whether we agree with it or not, this is its choice to make.

We are, however, seriously concerned with a number of the policy measures the Canadian Government proposes to achieve its objective.

These policies undercut current United States efforts to persuade other countries to move away from such measures and increase pressure for the United States to adopt similar policies—to the detriment of Canada and the world trading and economic system as a whole.

This Administration has pursued our investment problems with the Canadian government on the same three distinct but simultaneous tracks with which we are approaching our overall policy.

Internationally we, along with other countries, have raised our concerns regarding Canadian policies on trade and investment in varicus fora, such as the Organization for Economic Cooperation and Development (OECD) and the General Agreement on Tariffs and Trade (GATT).

We have initiated a large number of bilateral consultations with the Canadian Government in an effort to arrive at a satisfactory solution to these problems. These consultations are continuing.

We have also conducted through the Cabinet Council on Economic Affairs and the Trade Policy Committee an intensive review and analysis of our economic relations with Canada.

We are hopeful that we can resolve our current problems with the GOC in satisfactory manner. However, these types of issues will continue to arise; and unless they are seriously considered by international bodies like the GATT, their use will proliferate and the international trade and investment system will be seriously undermined.

While previous witnesses to the subcommittee would agree with this assessment, they have also pointed out that international attention will not be focussed on these issues until countries are forced to react. This may very well be true, and that is the reason why the CCEA review of our policy which we have begun is so important. We need to determine what actions would be appropriate if other governments are unwilling to address these issues in a meaningful fashion.

This was precisely our objective in conducting an internal Canadian policy review—i.e., to develop potential responses to Canadian policies which would be consistent with United States overall economic policy and at the same time respond meaningfully to measures adopted by the Canadian Government which adversely affect our interests and undermine the international trade and investment climate. The inherent problem in any such responses is that we don't want to take actions which would be detrimental to U.S. interests and place the international economic system in jeopardy. In our opinion, any actions which would restrict foreign investment in the United States could adversely affect our domestic economic program and ultimately would not have the desired effect of promoting a modification of Canadian investment policies. In fact, the Canadian Government would

prefer that Canadian firms invest in Canada rather than abroad. I would suggest that similar circumstances exist with regard to egregious investment policies of other countries, and a response "in kind" on investment may be counterproductive.

Other possible responses are, however, available or, as previous witnesses have noted, could be fashioned if necessary. The U.S. could, for example, where U.S. interests are adversely affected, take actions under the GATT or under our own laws, including section 301 of the Trade Act. We should also continue to develop more information on the impact of restrictive national investment practices on our economy.

CONCLUSION

In closing I would like to emphasize the following:

An open, market-oriented approach is the best policy for the United States to adopt toward international investment.

The USG should continue to press for some discipline on the use of national measures to restrict or manipulate international investment flows.

However, because of the importance of international investment and because of the restrictive measures employed by other countries we must, as we are now doing, review the implications of this open, market-oriented approach for our economy.

In particular, we should develop more information on the impact these foreign policies are having on our economy.

Finally, we should begin to develop U.S. policy responses to those policies which are damaging our economic interests and which will not be changed.

The CHAIRMAN. Thank you, Mr. Leland.

Mr. Hormats.

STATEMENT OF ROBERT D. HORMATS, ASSISTANT SECRETARY, ECONOMIC AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. HORMATS. First let me say, Mr. Chairman, I very much welcome the opportunity to testify here. I think the hearings are particularly timely and useful in promoting a dialog on international investment issues. And I have been particularly impressed by the statements of other witnesses in the private sector who appeared before this committee. I have had a chance to go over some of them, and I would like to draw on them as I go along. I will briefly summarize.

The CHAIRMAN. Mr. Secretary, some people in the room seem to be having trouble hearing. If you could get closer to the mike.

Mr. HORMATS. Let me make a few general points and ask that the rest of my testimony be incorporated into the record.

As I see it, there are two major investment-related challenges before us in the 1980's. The first relates to the need to establish new international understandings in order to avoid short-term nationalistic approaches to investment. In my judgment, we risk today in the international investment area a serious deterioration in the climate, similar to that experienced in the world trading arena in the 1930's. During that period, as you will recall, there was an adoption by many countries of nationalistic policies based upon short-term economic policies, with major economic and ultimately political costs.

In the post-World War II period, nations have made a major effort to avoid narrowly nationalistic trade policies and, in fact, have made a lot of progress in so doing. We have some distance to go in the trade area, but basically the direction and emphasis of the effort is correct.

In the investment area, however, no comparable framework has emerged, and there is a tendency on the part of developed and developing nations alike to move in the wrong direction, to increase intervention in the investment area in order to accomplish short-term objectives. This can only come at the expense of broader, longer term interests.

The United States has long favored an open international investment system, and as all previous witnesses have noted, this policy has served us well by facilitating capital flows and promoting the efficient allocation of capital resources.

The major U.S. goal in the 1980's therefore must be to reverse the trend toward Government-induced distortions in the investment process through international understandings and rules leading to a more open and less interventionist investment climate.

The second challenge, and one which was in fact discussed at the recent Cancun summit, is to create through cooperation among developed and developing nations an international environment in which investment can make a greater contribution to the development process. Many developing countries have already undertaken major improvements in their investment climates. Many have not.

I think it is quite clear that those who have more favorable climates for foreign investment have managed to do reasonably well in attracting such investment and taking advantage of export opportunities which come from that more fertile investment climate and, in part, are bought with the private investment which comes in. Many of them have also succeeded in obtaining a lot of technology through flows of private investment.

Let me make just a couple of broader points. First, I think in the 1980's the climate for private investment will be much more competitive. A number of developing countries have had a sort of porcupinish attitude toward private investment in the past.

I think in the 1980's, given the fact that investment is important and given the likelihood that foreign assistance is going to be limited by tight budgets, there will be a much greater degree of competition for private investment, and many countries are going to make major efforts through incentives and other types of policy measures to attract such investment, including countries which have not really been in the investment game before.

This brings with it pluses and minuses. The plus is that it can make a contribution to the development process. The problem is that through investment incentives and through investment performance requirements, there will be major distortions in international investment which will also cause major distortions in international trade.

And this is one of the very important things that we have to address, and I believe Commerce has done us all a great favor by putting down these investment performance requirements in a way which allows us to judge their impact and magnitude.

A second area that I just want to make note of is that of the protection of foreign investment abroad. It is my judgment that the United States does have a major responsibility to provide full support for American investors who desire it, in order to insure that the principles of national and most-favored-nation treatment and the

rights of the American firms under international law are adhered to by host governments.

American investments abroad, in my judgment, make a positive contribution to our own economy and to that of host nations. The U.S. Government cannot remain neutral while its citizens who invest in other countries, relying on their adherence to international principles and international law, find their interests threatened by derogations from such principles and law.

We believe in the concept of fairplay. We practice it in the United States and our investors abroad should expect no less. And I think it is particularly important during this period for the U.S. Government to be as supportive as possible of American private investors who find their interests compromised or threatened by the activities of foreign governments.

The real challenge before us in protecting American investment and dealing with the overall question of the investment climate is to try to develop an international consensus which develops rules and understandings about treatment of investment.

We have to move relatively soon from the discussion phase to a serious effort to develop and implement bilateral and multilateral understandings and rules which will reduce distortions of investment and promote a more open global investment climate.

This, I believe, should be one of the major goals for the United States and for the international community in the 1980's. And I think it is going to be particularly important for the agencies represented here to work very closely with the private sector.

In the consultations I have had with the private sector on this issue, they have provided very useful advice and very useful support; working with them and with this Congress, we will try to develop an assertive U.S. policy which supports American investors abroad and promotes improvements in international rules and understandings so that the open investment climate that we want and believe to be in our interest can be achieved.

Thank you, Mr. Chairman.

[Mr. Hormats' prepared statement follows:]

Prepared Statement of Robert D. Hormats

I am pleased to be here today to discuss U.S. policy toward international investment. These hearings are particularly timely and useful in promoting a dialogue on international investment issues as we seek to develop effective policies to meet the international investment challenges of the 1980's. I have read with great interest the statements of the other witnesses who have appeared before this Committee, and I am impressed by the thought that has gone into them. I will draw on some of the key elements in these testimonies as I discuss with you trends and problems in international investment, the key investment challenges of the 1980's and possible U.S. policy prescriptions.

NEW CHALLENGES IN INTERNATIONAL INVESTMENT POLICY

As I see it, there are two major investment-related challenges before us in the 1980's. The first challenge relates to the need to establish new international understandings to avoid short-term nationalistic approaches to investment. We risk today in the international investment area a serious deterioration in the climate similar to that experienced in the world trading arena in the 1930's. During that period, countries adopted nationalistic policies based on short-term economic perspectives. The economic and political costs have been well documented in history.

In the post-World War II period, nations have made a major effort to avoid narrowly nationalistic trade policies. We have made considerable progress in developing an international framework for trade matters. Although we still have some distance to go, the direction and emphasis of our effort is correct.

In the investment area, however, no comparable framework has emerged, and there is a tendency on the part of developed and developing nations alike to move in the wrong direction—to increase intervention in the investment area in order to accomplish short-term objectives. This can only come at the expense of broader long-term interests. The United States has long favored an open international investment system. As all previous witnesses have noted, this policy has served us well by facilitating capital flows and promoting the efficient allocation of capital resources. A major U.S. goal in the 1980's therefore must be to reverse the trend toward government induced distortions in the investment process through international understandings and rules leading to a more open and less interventionist investment climate.

The second challenge is to create, through cooperation among developed and developing nations, an international environment in which investment can make a greater contribution to the development process. Investment can be a powerful impetus to development, and is particularly important at a time of tight aid budgets. The developing countries themselves have a major responsibility to improve their investment climates through hospitable policies and respect for international laws and norms. This point was widely recognized at the recent Cancun Summit. Similarly, there was broad recognition that the international community can play a helpful role in facilitating investment to those countries which offer an attractive investment climate and that the overall world economy can benefit as a result.

THE INTERNATIONAL INVESTMENT CLIMATE

International investment capital was readily available until the mid-1970's' and foreign direct investment activities—except for several major expropriation cases early in the decade—proceeded at a healthy pace.

Since the mid-1970's, there have been important changes in international trends and forms of investment. The pace of international direct investment flows has slowed, particularly to many developing countries, and the 1980's are likely to be a time of capital scarcity and competition for foreign investment. It also appears that what capital is available will be more expensive than we were accustomed to in the 1970's. Increasingly, many countries are turning to investment incentives to attract foreign investment in specific industries. A number are also utilizing performance requirements to boost exports or increase local content. In addition, the recent increase in foreign investment in the United States, coupled with instances of discrimination against U.S. investment abroad, is generating concerns which are increasing pressures for more restrictive U.S. policies on inward investment. We need to deal with these issues in ways which maintain and expand the fundamentally open international investment system so necessary for global economic efficiency.

FLOWS

A brief review of international investment trends will help to put these issues in perspective. Although foreign investment has played an important role in the international economy since the last half of the 19th century, most was in fixed interest portfolio investments until the 1920's. After World War II, the global economic climate improved dramatically and generated an upsurge in private direct investment. U.S. private investment in Europe increased markedly, and was a key element in Europe's recovery. U.S. investment in some developing countries also expanded and played a significant role in the economic growth of many of those countries. The benefits of increased direct investment flows were, and continue to be, additional employment; additional capital to expand plant capacity or create new facilities; transfers of new and improved technology, and management skills; increased production; and greater competition.

The period from the early 1960's to the mid-1970's witnessed a rapid development of international direct investment both in absolute terms and relative to the growth of other economic aggregates such as trade, domestic investment and GNP. The United States remained the principal country of origin, although some European countries began to be more active as direct foreign investors.

International direct investment was heavily oriented towards developing natural resources at the outset of this period. However, direct investment in manufacturing sectors developed considerably as the period progressed. Over the 1960–1973 period, the average annual growth rate of total outward international direct investment flows from the thirteen largest OECD countries was over 12 percent a year. This figure was approximately one and one-half times the average growth of OECD GDP, and practically the same as the growth of international trade (14 percent).

This period also witnessed the rapid growth of multinational enterprises with extensive international operations. These enterprises have developed highly sophisticated production techniques and investor-supplier arrangements. Often, each subsidiary or subcontractor specializes in the production of a particular product or component. Product lines in the so-called "world industries," such as the "world cars," often result from coordinated production activities in a number of countries.

U.S. direct investment abroad grew from $11.8 billion at year end 1950 to some $140 billion by the mid-1970's (and $213 billion by year-end 1980). Most of this increase was channeled to the developed countries which, by the mid-1970's, accounted for some 70 percent of the total, compared with less than 50 percent in 1950. There are two primary reasons for this trend. Investors were attracted by the relatively stable, hospitable investment climates in the developed countries, particularly the virtual absence of risk to investment due to political turmoil. In addition, the generally booming economies of the developed countries offered the prospect of higher profitability for investments in those countries than in the developing countries.

The period since the mid-1970's stands in quite sharp contrast with the period which preceded it in a number of important respects.

A slowdown in the real growth of direct investment flows has occurred.—Using only capital flows as a measure, the average annual growth rate of outward direct investment from the thirteen largest OECD countries in the period 1974–1979 was slightly less than the 1960–1973 period (11.9 percent versus 12.6 percent). Considering the markedly higher rates of inflation during the most recent period, there has been a sharp deceleration in real terms. It is noteworthy, however, that international direct investment has remained more buoyant than domestic investment thus suggesting that multinational enterprises may have been better able to adapt to new and less favorable economic circumstances. This could be due to MNEs' wider ranging operations and product lines, which may enable them more easily to redirect their activities away from unprofitable ventures to more profitable activities. In addition, MNEs probably have better access to the financial and R&D resources needed to remain competitive during periods of economic turbulence.

There has been an increase in the foreign share of international direct investment.—While U.S. direct investment abroad still predominates, its share of total investment flows from OECD countries has fallen. As a percentage of outward direct investment of the thirteen largest OECD countries, the U.S. share has decreased from a peak of approximately 60 percent in the mid-1960's to about 35 percent in the late 1970's.

Particularly noteworthy is the change in U.S.-EC investment patterns. During the 1950's and 1960's, European integration, and an increasingly overvalued dollar toward the latter part of the period, induced considerable U.S. investment in Europe. At the end of the 1970's, the inducement effect of European integration wore off, and a decline in the value of the dollar caused a reversal of the trend.

More broadly, both Europe and Japan gradually shifted from post-war reconstruction to a more active role in the international economy. With this came increased foreign investment. Overall, the FRG's share of OECD direct investment flows grew from 7.2 percent during the 1961–1967 period to 17 percent during the 1974–1979 period. Japan's share grew from 2.4 percent to 13.0 percent, including extensive manufacturing investments in the Pacific basin, and France's share expanded from 6.9 percent to 7.8 percent.

There recently has been a sharpening of differences in the ability of developing nations to attract investment.—The growth of international direct investment flows from the fourteen major OECD countries to developing countries taken together has increased over the last few years in current and real terms. For example, the average annual growth rate of these flows during the 1973–1978 period was about 19 percent, up 10 percent from the previous five-year period. Furthermore, the total share of developing countries as host countries for the

foreign direct investment of almost all major investing countries has increased since 1974, thus reversing the generally declining trend of earlier periods. But this investment has been concentrated heavily in a few countries—in particular in the Republic of Korea, Taiwan, Singapore, Hong Kong and Brazil, which have emphasized export-led growth. Such investment has played a major role in the rapid growth of manufacturing in these countries.

In contrast to the experience of these countries, international direct investment has tended to stagnate in other developing countries, with the exception of the oil producing countries. It is of particular concern that U.S. and European direct investment in minerals in developing nations has stagnated in recent years. The primary reasons for this are the slack demand for metals and minerals due to the economic downturn in the developed countries, and increased investor perception of the political risk of investing in some mineral-rich developing countries. In view of the long lead times involved in developing new minerals sources, a global shortfall in exploration and new mine and smelter capacity could result in future shortages and/or sharply rising metals and minerals prices when the developed country economies turn upward again and world demand for these items increases. Such shortages and price increases could, in turn, constrain future global economic growth.

While there are sectional reasons for low foreign investment in many developing countries (the temporary fall in demand for metals and minerals is a good example), there are other "investment climate" factors, such as questionable national economic policies, fear of political instability, and negative policies toward foreign investment. Increased perception of political risk among potential investors is a key factor. Unclear and restrictive investment laws and regulations, and the unpredictability of their application, are other important elements, as are the increased use of performance requirements and restrictions on equity holdings.

NEW FORMS OF INVESTMENT

There have also been important changes in the characteristics of international direct investment. Recent OECD studies indicate that borrowed funds—essentially local currency borrowing—now represent a key source of financing for many firms, especially U.S. enterprises. In addition, an increasing number of medium-sized and sometimes even small-sized firms have begun to invest abroad in recent years. The development and internationalization of firms engaged in providing services necessary to direct investment, such as banks, has grown at a rapid pace since the beginning of the 1970's.

Enterprises are also diversifying their forms of investment. European state-owned enterprises have become increasingly significant investors in the OECD countries and in many LCDs. In addition, the "traditional" wholly-owned subsidiary form of operation is being increasingly replaced by non-equity forms of foreign direct investment, such as management contracts, licensing arrangements, etc.

The emerging trend seems to be a tendency towards flexible and pragmatic forms of ownership, management and control. These increasingly complex arrangements often involve several forms of control, cross control or joint activities. The emergency of new and more flexible forms of inter-firm relations is particularly noticeable in developing countries that are now endowed with substantial financial resources of their own or which can borrow abroad on their own account. A country in this position may put less emphasis on attracting foreign capital than on attracting foreign technology and management capacities.

PRIVATE SECTOR ROLE IN DEVELOPING COUNTRIES

Slower rates of global economic growth since the mid-1970's have hit most developing countries extremely hard. Adjustments to the soaring costs of energy and other resources, high interest rates, the decrease in the rate of growth of foreign investment in most developing countries, and sluggish world demand for many developing country exports have caused major problems for developing countries in addition to the traditional ones many already faced.

The United States has a strong interest in the economic development of developing countries. Taken together they are a larger market for U.S. exports than Europe and Japan combined. Foreign private direct investment can be a powerful impetus to the development process and a major—and increasingly important—supplement to official development assistance and other forms of private and pub-

lic resource transfers in stimulating growth in developing nations. Moreover, private flows are taking on added importance as the governments of the donor countries are facing serious budget constraints. Altogether, private capital flows—commercial lending and private investment—now account for almost 70 percent of total financial flows to developing countries.

There appears to be a growing perception by many developing nations that increasing foreign direct investment will be vital to their prosperity in the 1980's, particularly as aid prospects appear less promising. Many developing nations are seeking actively to attract foreign investors. Their success will depend largely on their investment climates and the steps that they take concerning it. As President Reagan noted in his October 15 speech on development issues, improving the climate for private capital flows is critically important as investment is the lifeblood of development. Clear and consistent investment-related laws and regulations, in conformity with the principles of international law, and according most-favored-nation and nondiscriminatory treatment of investment, along with other steps in the direction of a more open investment environment, will be determining factors in the decisions of many investors.

U.S. private direct investment abroad has played a particularly significant role in the economic growth of many of the success stories of development. Overall, U.S. investment in developing countries amounted to $11 billion in 1960, nearly doubled to about $19.2 billion in 1970, and more than doubled again to approximately $52.6 billion by 1980. The U.S. Government can play a helpful role in facilitating private sector involvement in those developing countries which seek to attract foreign investors. As a first step, we are supporting efforts of individual developing countries to create a more favorable internal climate for foreign and domestic private sector activity. In addition, we are:

Seeking ways to reduce U.S. business perception of risk in these countries through a renewal of OPIC's legislation with a broadening of the scope of its activities, and other USG programs, in developing nations;

Working to eliminate USG disincentives to U.S. private sector activities in developing countries (e.g., improved treatment of foreign-sourced personal income, amendment of our Foreign Corrupt Practices Act so as to define better the proscribed conduct);

Supporting pending export trading company legislation;

Exploring new ways to create a more open international climate for trade, investment and capital flows;

Increasing AID's private sector orientation;

Improving other USG programs that support the private sector in developing countries;

Increasing the involvement of individual U.S. firms and private business associations in providing management and technical training for developing countries' personnel;

Seeking more effective ways to bring together developing countries' enterprises and U.S. suppliers of appropriate technology; and

Considering proposals for the expansion of trade and development program grants for project feasibility studies and project design.

Further, by maintaining a free and open U.S. economy, we provide a market for nearly half of all developing countries' exports of manufactured goods to industrialized countries.

Another important step involves the negotiation of bilateral investment treaties (BITs) with developing countries desirous of attracting U.S. investors. Such treaties would enhance the attractiveness of investing in those countries by establishing a common frame of reference and legal base to deal with the entry and duration of investment; treatment of established investment; arbitration and dispute settlement; prompt, adequate and effective compensation in the event of expropriation; and repatriation and other transfer of assets.

A U.S. draft BIT is now undergoing a final review. We have received many helpful comments from the Congress and from the private sector. We will soon provide the final text to the Congress for review. We will then begin negotiations with Egypt. We hope to launch a series of negotiations with other developing countries desirous of attracting U.S. investors.

We are also seeking to give new vitality to, and to broaden the international effort to enhance private sector investment in, those developing countries where the environment is conducive to private sector growth. We believe the World Bank can play a highly effective role as a catalyst for increasing international flows of direct investment to developing countries. On a broad basis, its efforts to

foster market-oriented policies in developing countries and its support for basic infrastructure help pave the way for profitable private investment. On a project-by-project basis, it can attract additional private capital through cofinancing and other formulas that encourage U.S. banks and other investors to be more active in the developing countries. Even if the Bank finances only a part of a project, its participation improves the climate of confidence between foreign investors and the country in which the investment is taking place.

Within the Bank, the International Finance Corporation has a particularly important role to play. For the last 25 years, the International Finance Corporation has been working to encourage the growth of productive private investment in developing countries. It has a well-earned reputation for doing sound economic and financial analysis and for investing only in projects which have a good chance of earning a profit. As a result, its supplemental equity participation in a small porcion of an investment can attract private participation in the larger portion of that investment. Moreover, the IFC's catalytic support in putting together investment packages helps to develop countries' industrial infrastructures by filling gaps in the sector concerned, thereby allowing other related businesses to develop and grow. The IFC should receive greater support from developed and developing nations alike. I am extremely encouraged by World Bank President A. W. Clausen's September 29 statement before the World Bank's Board of Governors that the Bank will seek to increase substantially the level of private cofinancing in the next several years. We want to support the Bank in this endeavor.

Domestically, the new legislative authority for OPIC will permit it greater freedom to support private investment in middle income developing countries. At the same time, we are considering the possibility of working with other developed and developing countries to establish a multilateral insurance agency, which would protect investors against certain political risks in developing countries. Such an institution could help to facilitate investment in developing countries, and give greater confidence to new investors from countries which do not have their own national insurance agencies. Similar ideas have been considered before, but perhaps the timing now is more propitious because the desire among potential investors and potential recipients is greater. Again, I am delighted by World Bank President Clausen's statement that the Bank is prepared to join in an effort to see if such a mechanism can be established. This is one of the immediate tasks before us. We also welcome the increased interest shown by private firms in issuing political risk insurance in developing countries and are exploring ways in which we can cooperate more closely with them in this field.

As this Subcommittee is well aware, we have become increasingly concerned over the serious political, social and economic problems faced by many countries in Central America and the Caribbean. We are currently seeking to cooperate with the Caribbean Basin states in a practical way to develop programs to stimulate more rapid economic growth in the region. The U.S. portion of this initiative will focus in large part on enhancing the rcle of the private sector in these economies. Growth of a modern, efficient private sector is imperative to promote productive employment in the region and to generate exchange-earning exports.

We have no preconceived blueprint for determining the actions, joint and separate, which should be taken to increase regional productive capacity and achieve needed economic revitalization. We are now engaged in a series of consultations with Basin countries and other potential participants to determine those trade, aid, and investment measures which, when taken in combination with the efforts of the regional governments themselves to reduce internal constraints to economic growth, will help to reach our long-term goal of increased economic prosperity for the region. Many of the elements I have just outlined regarding our increased efforts to encourage and facilitate private sector involvement in developing countries will undoubtedly form part of the overall program. I am also encouraged that the Cancun Summit's recognition of the important role of the private sector in economic development, and the decisions taken in that regard, will give further impetus to our private sector and Caribbean initiatives.

OTHER CURRENT ISSUES

Capital shortage

As I mentioned at the beginning of this discussion, we expect the 1980's to be a time of capital scarcity and, therefore, competition for foreign investment. For the global economy to expand, increasing amounts of capital will be needed to sustain such growth. Increases in the global capital stock depend on many factors, and we

are concerned that the conditions necessary to stimulate an adequate level of growth in global economic activity may not be present. Capital formation may be insufficient to generate the desired amounts of investment. Particularly for developing countries which, other things being equal, normally should expect the highest growth rates, capital scarcity may well become an even more important constraint on growth than heretofore. This constraint is due to investor perception of the risks attached to investments in some developing countries and to the real limits on the amounts of international capital available for both domestic and foreign investment.

Performance requirements/investment incentives

As virtually all previous witnesses have testified, a central issue in the 1980's is the increasing intervention by host governments in the decision-making process of potential foreign investors. More and more often, governments are attempting to manipulate foreign investment to support their national economic goals. These forms of intervention, practiced by both developed and developing countries, take two broad forms.

1. *Incentives.*—Some countries offer significant tax, credit and other incentives to attract foreign investors. When such incentives distort decisions of foreign investors, there is a shift of production as well as jobs, technology, exports, etc. to the host country providing the incentives. Other countries competing for the investment on closer to economic terms lose out.

2. *Performance requirements.*—These include various performance commitments: minimum employment and export levels, local value added and content requirements, technology specifications, buy-back and marketing arrangements, etc. Most result in a shift of production to the host country on a noneconomic basis. Increasingly, host countries are combining the use of investment incentives and performance requirements. For example, Brazil offers various tax incentives to enterprises which utilize a high percentage of local raw materials and permits accelerated depreciation on locally produced capital equipment. It also accords tax and other incentives based on an investment's location and its export or import-substitution possibilities. This is leading to the development of unique bargaining situations in which the economic interests of the capital exporting countries may be ignored and trade and investment flows are distorted.

Performance requirements are not instituted solely by developing countries. For example, Canada's Foreign Investment Review Agency has leveled certain restrictive requirements on United States and other foreign firms, which I will discuss in a few minutes.

Our neighbor to the south, Mexico, also imposes performance requirements in key sectors. The 1977 Mexican automotive decree requires producers to obtain the foreign exchange requirements needed for their operations (e.g., for imported components and indirect foreign exchange costs such as interest and dividend payments made abroad) through the export of completed vehicles and parts, and allocates foreign exchange among the producers on the basis of, *inter alia*, the percentage of domestic materials incorporated in their products.

Performance requirements directly related to trade are of particular concern since value added requirements can generate effects similar to import quotas on components and other inputs. While such quotas would specifically be prohibited under the GATT trading rules, the rules are less precise when countries use their investment policies to achieve the same purpose. As a number of previous witnesses have noted, GATT has had little experience in handling these cases.

Other requirements, such as minimum export requirements, are inconsistent with both the GATT and the subsidy code, but because they are tied to investment agreements they may be very difficult to sort out. The net effect of these investment policies is to skew foreign investment in order to attain short-term industrial policy goals and to distort international trade patterns. Governments which do these things undermine international trading rules. Ultimately, the gains from trade barrier reductions would be offset by the losses incurred by economically inefficient investment policies.

We believe it is time to strengthen multilateral discipline and restraint over such government actions which distort international investment and thus international trade and production decisions. We need to focus the competition for foreign investment along the lines supportive of an open international investment system. Broad international acceptance of the principle of national treatment, greater discipline over the use of incentives, and agreement to limit, or better yet eliminate, the use of performance requirements as a policy tool would promote

global economic growth and would avoid future structural problems in artificially created and maintained national industries. In the short run, narrowly nationalistic actions are indeed tempting to us all. In the long run, we all benefit from an open, well functioning international economy. If, however, the system has to cope with too many short-term pressures, its long-run viability cannot be assumed. That is the risk we face today.

It is, therefore, clearly in the interests of all concerned to improve the international investment system by promoting its efficiency and openness and reducing various nationalistic actions. There are a number of fora where these issues can be addressed. Specific situations can be dealt with bilaterally. For example, we have held, and will continue to hold, high-level consultations with Canadian and Mexican officials. In this regard, the United States-Mexico joint bilateral Trade Commission, which last met September 21, provides an excellent framework in which to discuss such issues.

The OECD countries could seek to build a broader and deeper commitment to eliminating performance requirements and investment incentives, based on their 1976 investment understandings, and we have launched an initiative to that effect. Earlier this month, we suggested that the OECD should undertake a coordinated and expanded work program on investment issues. This work would include the strengthening and expansion of the national treatment principle, a strengthening of the consensus on incentives and disincentives, greater concentration on disincentives (particularly performance requirements), an agreement on what the OECD can do to reduce obstacles to private investment flows outside the OECD, and an agreement on ways to increase private sector investment flows to developing countries.

The Ottawa Economic Summit participants agreed that it is essential to remove impediments to capital flows. We need to strengthen the OECD consensus on these issues and to work to extend this consensus to the developing countries. We are hopeful that other OECD member states will agree with us that the time has come to begin turning the full analytical and policy formulating weight of the OECD toward one of the key emerging economic issues in relations with the developing countries. Initial responses to our initiative have been favorable.

Certainly the developing countries, particularly the newly industrialized countries, should be brought into such a consensus via subsequent or parallel work. The GATT could provide an excellent forum in which to accomplish this and I am encouraged that previous witnesses have recommended using the GATT to address these issues. In the GATT, we have already proposed action on trade-related performance requirements such as value added/local content rules and minimum export quotas. The 1982 GATT Ministerial represents an excellent opportunity to establish the political momentum needed to address seriously such problems. The GATT subsidy code and the GATT rules barring government intervention in trade flows can be interpreted to provide increased protection for investments. On the other hand, it may also be necessary to devise new GATT arrangements. In any case, the GATT's past attention to this subject has not been commensurate with the subject's implications for the trading system.

In addition, the IMF/IBRD Development Committee has completed an initial review of investment incentives, and the World Bank staff now proposes a major study on the matter. We strongly support such a study and hope that it can soon be started.

The ultimate goal of our work in these various fora would be the development of an international investment framework consisting of meaningful understandings and perhaps formal commitments, where possible, on these issues. We recognize that this will not be an easy task. The key factor is that the plethora of incentives, performance requirements and other restrictions differ qualitatively, thereby making more complex the problems involved in negotiating their elimination.

Services

As I noted in my discussion of investment trends, international investment in the services sector—banking, insurance, communications, etc.—is increasing at a rapid rate. The growth of the services sector can play an important role in facilitating other types of investment. For example, international banks and insurance companies may be the only enterprises in their sectors with sufficient resources and expertise to finance and insure some foreign direct investments, particularly in developing countries. Service industries also provide management capabilities, communications and date flows which are essential for the efficient

operation of large companies with extensive international operations. However, many countries do not accord these forms of investment the same treatment they accord to corresponding domestic enterprises. Instead, they provide special protection to their domestic service sector firms. We believe that international direct investment, including investment in the services sector, should receive fair, equitable and non-discriminatory treatment.

Treatment of investment

The United States believes in two basic tenets for treatment of investment: the national treatment principle and the most-favored-nation treatment principle. The national treatment principle holds that foreign investors should be treated no less favorably than domestic investors in like situations. The most-favored-nation treatment principle holds that the investors of one foreign country should be treated no less favorably than the investors of other foreign countries. The two principles have the common characteristic of reducing instances of discrimination directed at foreign investment.

We have worked bilaterally and multilaterally to achieve the widest possible acceptance of these principles, and to extend the application of such treatment to a wider range of enterprises. A particularly important step in this process took place in 1976 when the United States joined other OECD member governments in participating in the consensus adopting a Declaration and Related Decision on National Treatment. The Declaration and Decision were reviewed and reaffirmed in 1979 by a consensus of OECD countries in which the United States also participated. The Declaration states in part "that member countries should, consistent with their needs to maintain public order, to protect their essential security interests, and to fulfill commitments relating to international peace and security, accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another member country * * * treatment under their laws, regulations and administrative practices consistent with international law and no less favorable than that accorded in like situations to domestic enterprises * * *."

Since the Declaration and Related Decision on National Treatment were adopted in 1976, progress has been made toward refining the concept, including a listing of those exceptions which now exist and their rationales. Continuing work is in progress with a stated goal of extending the application of national treatment over time. The very existence of the Declaration and Related Decision on National Treatment has probably had some effect in discouraging member countries from implementing measures which would constitute new derogations from the principle. Moreover, at the request of the United States, joined by several other OECD member countries, the consultation procedures of the OECD instruments were used for the first time in March 1981 to hold formal OECD consultations on Canada's National Energy Program.

We are now seeking a more active OECD effort on national treatment matters. Earlier this month, U.S. delegations to two OECD meetings proposed initiatives in this area which were favorably received by the other OECD member states. Although the details of an expanded work program remain to be more clearly specified, the objective will be to maintain progress toward—and hopefully accelerate—the reduction of exceptions to national treatment, to strengthen the ongoing notification process and consultation merchanisms, and to concentrate on improving the terms of access and treatment of service industries. We are also seeking an explicit member state commitment to the extension of national treatment. In this regard, our goal is to develop an OECD consensus to work for broader international recognition and acceptance of the national treatment principle. As previous testimony has indicated, national treatment is clearly in the interests of all concerned as it is a critical element in fostering an attractive climate for foreign investment.

U.S. investment abroad: Investment disputes and protection

In looking for ways to facilitate investment in developing countries, we know that adequate dispute settlement arrangements and protection from expropriation are critical elements in business' assessment of the investment climate in any given developing country.

Involvement by the U.S. Government of behalf of U.S. investors involved in disputes concerning potential or actual expropriation has been for many years to encourage the parties to seek fair and effiective means of resolving such disputes as early as practicable, whether it be by negotiation, arbitration, or other means,

including legal action in the courts of the expropriating government. In the first instance, our emphasis is on facilitative assistance—for example, encouraging and arranging useful discussions between investor and host government and collecting information on their respective positions.

To minimize the incidence of expropriation and to facilitate prompt payment of effective and just compensation to our property owners when expropriation occurs, the United States:

Seeks acceptance in our bilateral and multilateral relations of the principle that an international minimum standard exists for treatment of foreign investors;

Presumes that new bilateral economic benefits and support for loans being considered in international financial institutions will be withheld from countries that expropriate significant American interests without taking reasonable steps to provide compensation;

Applies existing legislation that suspends bilateral assistance, requires a negative vote on loans in multilateral development banks, and denies eligibility for trade preferences to countries that expropriate property of U.S. citizens without discharging their obligations under international law;

Protects its investors by offering investment insurance through the Overseas Private Investment Corporation (OPIC) against the risk of expropriation in friendly developing countries;

Encourages independent appraisal as a method of valuation, and the use of agreed procedures for resolving investment disputes, including the facilities of the World Bank's International Center for the Settlement of Investment Disputes; and

Keeps under active review all cases of actual or potential expropriation of American property abroad, taking appropriate steps to assure fair treatment for our citizens in conformity with international law.

Virtually all previous witnesses have underscored the need for the U.S. Government aggressively to pursue national, nondiscriminatory treatment for its investors abroad, consistent with international law, and to provide full support in cases of expropriation and other similar matters. I want to reiterate that we believe strongly that investors should be accorded treatment consistent with international law, including nondiscriminatory treatment and prompt, adequate and effective compensation in the event of expropriations. As I have noted, investor confidence that host countries would adhere to international law and norms would significantly facilitate investment flows.

It is, in my judgment, the responsibility of the U.S. Government to provide full support for American investors who desire it in order to ensure that the principles of national and most-favored-nation treatment and their rights under international law are adhered to by host governments. American investments abroad make a positive contribution to our own economy and to that of host nations. The U.S. Government cannot remain neutral while its citizens who invest in other countries relying on their adherence to international principles and law find their interest threatened by derogations from such principles and law. We believe in the concept of fair play. We practice it, and our investors abroad should expect no less.

Canada

The USG is concerned about Canada's restrictive policies in its energy sector, embodied in its National Energy Program (NEP), and the activities of its Foreign Investment Review Agency (FIRA). I do not want to dwell today on Canada's actions, but I think it is important briefly to review some of them as a way of highlighting the need to develop better international discipline on investment policies.

Our key concern about the NEP is its discriminatory and unfair treatment of foreign investors. Elements of the program which are of most concern in our view are:

The 25 percent crownshare, or "back-in," in existing oil and gas discoveries in Canada lands. This is unfair in that it changes the rules of the game for foreign firms who have invested in exploration and development of Canadian energy resources. The Canadian Government subsequently has agreed to pay a portion of the exploration costs incurred by the companies in Canada lands, but the compensation now being considered will almost certainly be inadequate to meet the expenses incurred by the firms and would not, in our view, be compatible with international standards in this regard.

The old system of depletion allowances will be replaced by the Petroleum Incentives Program (PIP). Under the PIP, the level of Canadian ownership

determines the exploration grants awarded to a company, with the maximum grants awarded to companies with Canadian ownership of 65 percent or higher.

Canada also has established a Committee on Industrial and Regional Benefits (CIRB). The objectives of this Committee include increasing participation of Canadian firms in major projects and increasing procurement of Canadian goods and services in this sector. The operations of the CIRB may be in conflict with the provisions of the GATT.

Other elements of the NEP are also of concern. The Canadian Government may take nationality into account in future natural gas export decisions. Current Canadian oil and gas pricing and taxation policies, which reflect agreements reached with provincial authorities, may not stimulate an adequate level of exploration and development of Canada's hydrocarbon reserves.

The Foreign Investment Review Agency (FIRA), is a screening agency which carefully monitors incoming investments. We do not challenge FIRA's basic premise—the review of inward investment. Our problems center on the operations of FIRA. First, in judging whether to approve an application by a foreign investor, FIRA uses a general and rather vague criterion: whether there is significant benefit to Canada. Second, the very existence of FIRA undoubtedly discourages many would-be investors. Third, in many cases the FIRA extracts "undertakings" from prospective investors before approving an investment proposal. These are legally enforceable agreements—performance requirements—and take the form of market-distorting Canadian sourcing requirements, export commitments, requirements to hire specified levels of Canadian management and labor, obligations to move productive facilities from the United States to Canada, obligations to transfer patents and know-how to Canada without charge, and other commitments which run counter to generally accepted international practices. These measures have potentially serious distorting effects on investment and trade flows between the United States and Canada.

The extraterritorial effect of FIRA is also worth noting. FIRA asserts the right to review the changes in ownership of Canadian subsidiaries of U.S. firms. This could occur when two American firms merge. These transfers are frequently disapproved by FIRA, even in situations where there is no change in the level of Canadian ownership. This FIRA policy has the effect of depressing the value of the U.S. firm's assets in Canada.

We have some reports that Ottawa is not now pressing earlier proposals to expand FIRA's mandate to review and monitor already established foreign investments in Canada. This is certainly a positive development, because such an expansion of FIRA's mandate would have been a serious new deviation from international norms. Also, we understand that the FIRA is considering adopting a more explicit and open policy on its decision-making process. This would also be a positive step.

We have had numerous consultations with the Canadians on the NEP and the FIRA. We held high-level discussions with them in Ottawa at the Economic Summit. In September, a group of Canadian officials visited the Department for consultations about the NEP and, subsequently, in Grand Rapids, the President met with Prime Minister Trudeau. Most recently, on October 13 Treasury Secretary Regan, Assistant Secretary Leland, and Ernest Johnston, my Deputy at the State Department, traveled to Ottawa to reemphasize to the Canadian government our interest in resolving our differences amicably and expeditiously. We appreciate the willingness of Canada to have further exchanges with us and we believe this is indicative of the traditionally open relationship between the two countries. We have also been joined by other nations in expressing concern over Canadian policies. In particular, we have formally pressed our concerns in the OECD over these elements of the NEP which are regarded as derogations from national treatment. Additional OECD discussions were held earlier this month. We are also assisting on a case-by-case basis those U.S. firms which are adversely affected by the FIRA's administrative procedures.

Codes of conduct

Another element related to international investment concerns efforts to develop international codes of conduct, or guidelines, relating to multinational enterprises. Over the last-half decade, the United States has been participating in negotiations on the elaboration of such codes. The OECD and the International Labor Organization have developed general codes for MNEs. The UNCTAD has promulgated a more narrowly focused code on restrictive business practices. In addition, a U.N. working group has completed draft provisions on about two-

thirds of an overall U.N. code relating to the activities and responsibilities of transnational corporations and governments. However, hard issues remain to be resolved, such as those on nationalization and compensation, and it is not certain whether the negotiations will be successful. Negotiations on a code of conduct relating to the transfer of technology are presently stalled and the matter has been referred to the UNGA for further consideration.

In the U.S. view, guidelines which affirm standards of good practice for both enterprises and governments can contribute to improved relations between firms and governments and may limit the tendency for unilateral government intervention in investment matters. Through appropriate provisions on nationalization and compensation, jurisdiction and dispute settlement they may also be able to reduce conflicts between governments over investment issues, thereby facilitating the liberal climate for international investment which we seek. However, the United States can support only guidelines or codes that are voluntary; do not discriminate against MNEs in favor of purely national enterprises; are balanced to include references to the responsibilities of governments as well as of MNEs; and apply to all enterprises regardless of ownership—whether private, government or mixed.

It appears that international interest in developing codes of conduct may well be diminishing as other investment issues, such as capital scarcity, have become more urgent. The principal investment issue is no longer controlling multinational enterprises but methods used to attract and facilitate investment by them.

Foreign investment in the United States

The value of foreign direct investment in the United States has increased in recent years—28 percent in 1978 ($42.5 billion), 23 percent in 1979 ($54.5 billion), 20 percent in 1980 ($65.5 billion). (U.S. direct investment abroad, by contrast, is $213 billion). Roughly one-third of the foreign direct investment in the U.S. is in manufacturing ($24 billion). wholesale and retail trade account for about 20 percent and petroleum 19 percent. Real estate holdings by foreigners, while often publicized, amount to only about $2.5 billion. The largest single sources of foreign investment have been the Netherlands ($16 billion), the U.K. ($11 billion), and Canada ($9 billion). Less than $1 billion comes from the Middle East.

This investment has had a positive effect on many sectors of our economy. It has helped to create jobs. It is estimated that in 1979 U.S. affiliates of foreign companies employed about 2 million Americans with total employee compensation amounting to about $29 billion. It has added plant capacity and created new facilities. It is estimated in 1979 that affiliates' expenditures for new U.S. plant and equipment reached $10 billion. It has brought in advanced technology and management skills. In 1979, foreign-owned U.S. affiliates contributed around $1.5 billion to our research and development efforts. It has also assisted us in our balance of payments. In 1979 it is estimated that U.S. affiliates exported about $43 billion worth of goods and services. Moreover, additional inward investment flows will assist our economic revitalization efforts.

This Administration welcomes foreign investment in the United States for the reasons I have cited: job creation, technology transfer, increased plant capacity and new facilities, balance of payments benefits, and economic revitalization. Yet, foreign investment represents a very small proportion of our total investment and our total assets. Moreover, U.S. law provides a number of safeguards which are designed to protect our national security and other vital interests. The vast bulk of this legislation is nondiscriminatory, applying equally to all investment in the United States regardless of the nationality or ownership. Some of these laws do constitute exceptions to national treatment, but with a few exceptions, most are widely recognized as legitimate restrictions justified on essential security or other grounds. Foreign investment is restricted, for example, in sectors of the U.S. economy relating to national defense, nuclear energy, transportation, and exploitation of federally-owned land. A number of states also have their own limited restrictions on foreign investment in such areas as banking, insurance, and land ownership.

In addition, the U.S. Government keeps a watchful eye on trends in foreign investment through the Committee on Foreign Investment in the U.S. (CFIUS). The purpose of this group, chaired by the Treasury Department, is to monitor the impact of inward investment, including the review of foreign investments which might have major implications for U.S. national interests, and to coordinate U.S. policy implementation. CFIUS oversees the efforts of several government agencies

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such as the Department of Treasury, Commerce, and Agriculture and coordinates the activities of other executive and regulatory agencies in the area of foreign investment. CFIUS facilitates greater coordination among the executive agencies that have authority and responsibility for implementing federal laws and regulations affecting foreign investment activity in the United States.

The Committee, since its formation, has operated on the basic premise that the review activities should be limited to cases where there is a genuine concern about the U.S. national interest. It has also continued to make a distinction between private foreign investment and investments by Government-controlled firms. We are also concerned about possible problems associated with investments in the United States by foreign government-controlled entities, and that such entities could enjoy special advantages over their private competitors in the areas of taxation, information disclosure, etc. There could also be special national security implications. A Treasury Department-chaired working group of the Cabinet Council on Economic Affairs, with active State Department involvement and support, is currently conducting a review of the issues involved.

The recent rapid growth in foreign investment in the United States, coupled with restrictions on and discrimination against U.S. investment in other countries, is, however, tending to generate pressures in the United States to control inward investment and/or regulate it on a more reciprocal basis. The reaction to Canada's restrictions against foreign investors, particularly in the energy sector, and the spate of new investments sought by Canadian firms in the U.S. minerals sector feed such pressures. The intensity of U.S. concern is, of course, directly related to the magnitude of economic relations between the United States and Canada. There have been calls for prohibitions on investment in specific sectors, greater screening of foreign investment, and the establishment of a reciprocity principle in U.S. treatment of investment.

Clearly, for the many reasons mentioned earlier, I believe that we should react strongly to unfair treatment of U.S. investment abroad. However, for a number of reasons, it is necessary to react in ways which genuinely serve our interests. Policies which would restrict inward investment, or other countermeasures, should be used only after all of their implications are weighed. First, the ultimate results might adversly affect the United States as much as, or more than, other countries. We need to be cautious about limiting foreign investment because of the benefits from such investment. We need the jobs, new technology and management skills that foreign investors can supply. A secure and stable investment climate is one of the major strengths of our economy and a major source of our prosperity. Short-sighted or arbitrary actions which raise doubts among potential foreign investors would be harmful to our domestic economic interests. In the long run we might be the losers, not the country that we retaliated against.

Second, we must take into account the fact that the United States is also a large investor abroad and is a major force in international trade. We have a vital interest in maintaining maximum freedom of investment and capital flows in the world economy. United States policies concerning foreign investment in the United States have a significant impact on the policies of other countries toward foreign investment, and U.S. restrictions could invite retaliatory actions by others. As Mr. Roberts of the National Foreign Trade Council insightfully noted, the most appropriate USG response to some restrictive foreign government policies may well be a policy of patience.

Third, we want to assure that our response is appropriate, consistent with international norms, and effective. I therefore believe, as do most of the other witnesses who have appeared before this Committee, that, while counterreactions of the type mentioned might in extreme cases be useful, we are clearly better served by policies that aim at the elimination of foreign practices that deviate from international norms than by policies of retaliation that could weaken these norms. As Mr. Connor of Price Waterhouse so succinctly put it, the goal should be to build bridges rather than walls to international investment flows. With this principle in mind, we intend to take steps necessary to protect our rights and interests.

CONCLUSION

Many of the issues I have discussed today were nonexistent or only nascent just a decade ago. They have come to the fore over the last few years as a result of real economic forces which are reflected in the investment trends I have outlined. As virtually all the previous witnesses have noted, the issues, such as investment

incentives and performance requirements, must be addressed if we are to maintain and strengthen the open international investment system essential to global economic efficiency. We need to focus the competition for foreign investment along lines supportive of such a system.

By their very nature, many of these problems will not lend themselves to easy solutions. In particular, urgent short-term national economic goals vary widely, thereby making more difficult the achievement of an international consensus on some issues. However, all countries have a stake in the long-term viability of the international economic system; this provides a good basis upon which to proceed in addressing these problems in earnest.

Bilateral and multilateral fora will provide important arenas in which to tackle the problems involved. We now plan to move from the discussion phase to a serious effort to develop and implement bilateral and multilateral understandings and rules which will reduce distortions of investment and promote a more open global investment climate. This is one of our major goals for the decade of the 1980's.

The CHAIRMAN. Thank you very much. Several years ago we were honored by a visit from the Prime Minister of Canada, Mr. Trudeau. It was at the outset of the program he had announced for national energy. The purpose of his trip was really to explain to Members of Congress and, in particular, Members of Congress in the border areas who were going to be feeling the immediate impact of the change in energy policy in Canada, exactly the basis for that program and how he envisioned that it would work.

Now we are several years downstream from that, and there are reports that drilling rigs that previously were used in Canada are now being moved across the border instead of the oil, that foreign investment in Canada has slowed down, which may have been one of the objectives, but that in fact Canadian capital is being invested in the United States in an increasing volume, which I doubt was one of the objectives of that program.

CANADA A LESS ATTRACTIVE PLACE TO INVEST

So that it would appear that this is a policy which has made Canada a less attractive place in which to invest, both from the point of view of the Canadians themselves and from the point of view of foreign investors.

Is that a fair assessment of the picture? Mr. Leland, you are the expert in this field.

Mr. LELAND. I think it is, Senator. It would be wrong to say that it has not had a negative effect on investment in Canada. We have had discussions with the Canadians in general on this.

I think that there is a combination of factors that have done it. One, the NEP in the energy area, if and when it comes into effect, which it has not yet in any way, shape, or form, will certainly be a negative impact. The petroleum incentive program (PIP) will make it much more advantageous for a Canadian-owned company than for a non-Canadian-owned company to operate in Canada. Obviously, these factors will affect the flows of investment.

In addition to the energy program, the FIRA, which screens investment, is a deterrent. When in addition to screening you also have performance requirements imposed, it makes it much more difficult, and could keep investment out.

Many Canadians, including portions of the Government—are concerned about their problem. There are countervailing or competing interests at work. One objective is "to Canadianize," and the other is

not to lose the advantages that foreign investment brings in. We have to point out to them the advantages of foreign investment so they do not go too far in one direction.

The CHAIRMAN. In using the Canadians as an example, I am not being critical of them. They certainly can adopt any national policies that they see fit to adopt for themselves.

But I am interested in the effect of this kind of policy, because there are some voices within the United States that talk about similar policies or policies that have the same general direction of restricting investment and placing limitations and restraints on investment. And it is useful to observe how these policies actually operate in practice in other places.

Mr. WALDMANN. I wonder if I might add a few comments. We did discuss some of these same issues with a group of Canadian businessmen on Monday of this week and I gave them some statistics on what has happened in the last couple of years. The increase of Canadian investment in the United States in the last 3 years has been 70 percent, that is, in 3 years the amount of Canadian investment in the United States has gone up 70 percent. The amount of U.S. investment in Canada has increased by only 23 to 25 percent.

There were a few oil people in this group, and they confirmed that there are now Canadian drilling rigs moving south. I have heard the number was 300, but I do not know how one keeps track of that particular figure.

And finally, we have seen in the last 2 years a substantial increase in the number of takeover transactions and other kinds of transactions by Canadian companies in the United States from about 150 transactions a year to an annual rate of about 300. So those would give you some idea of the magnitude of the shift just in the last 3 years.

INVESTMENT MEASURES

The CHAIRMAN. If we need to respond to Canadian performance requirements or to other policies that are affecting the mutual interests here, would you think we ought to look at investment measures, or should we consider trade or taxation measures to reciprocate in an appropriate way?

Mr. LELAND. The main thing one wants to avoid doing in all of these situations is the overused phrase of "shooting ourselves in the foot." We basically believe in the free flow of investment. That is why I think the concept of always reciprocating in kind or retaliating in the same method may not achieve the objective we want.

Also as you said, I do not think the Premier of Canada believed his policy would increase Canadian investment in the United States or that it was necessarily desirable to have Canadian funds sent to the United States. So methods that might send the funds back to Canada or keep Canadians out of the United States might just strengthen Canadian practices rather than weaken them.

What one has to do is examine, in all of these areas, the kind of methods that might be used, starting with persuasion and with showing them exactly what is happening—as Mr. Waldmann said, pointing out what they are losing by this. If this approach does not yield results, we have international mechanisms to go to, and eventu-

ally, if need be, trade and tax retaliatory measures, but that would be meaningful, not counterproductive.

The CHAIRMAN. So you would say, "No taxation without persuasion."

Mr. LELAND. It sounds like a good motto.

The CHAIRMAN. First, at any rate.

Mr. LELAND. First, it may be that part of the job is showing people the error of their ways and where things get carried farther than anyone intended.

PENDING TAX TREATY

The CHAIRMAN. What about the pending tax treaty with Canada? Would some further consideration of that be an appropriate response?

Mr. LELAND. I have discussed it with our tax people who negotiated it and it is supposed to have an equal number of benefits and detriments. The United States will be getting quite a bit out of it. So, again, it is a shoot-yourself-in-the-foot type problem.

There is at least as much in that treaty for us as for Canada. So whether or not you would want to stop the treaty, which might be just as disadvantageous to us as to them, is a question. I think a lot of American businessmen who are doing business in Canada are very interested in having that treaty.

In addition, we already have a treaty with Canada. This is a continuation of it.

ARTICLE XXII CONSULTATION IN GATT

The CHAIRMAN. What about an article XXII consultation in GATT?

Mr. LELAND. An article XXII consultation in GATT is certainly an idea, and one that has certainly been considered. It is a very mild thing to do. I mean, it is really asking for consultations in a broader sense than the bilateral consultations now underway. I think everybody here would agree with me, that if we do not get results very soon from the Canadians, that is certainly the very least we would intend to do.

The CHAIRMAN. I am encouraged that your thinking moves in these directions and is not simply confined to accusations and punitive proposals, because I think that does end up, as you say, shooting yourself in the foot.

At a very early stage in the 1980 Presidential campaign, President Reagan made a rather intriguing proposal for what, as I recall, he entitled a "North American consortium." He envisaged the North American Continent, with its extraordinary resource, should coordinate its economic and political activities on a much closer basis than we have heretofore.

He even went so far as to propose that we might have some special commissioners from Canada and Mexico who would sit with the Cabinet and participate in decisions that would affect the whole continent.

DEVELOPMENT OF A COMMON MARKET

That has not taken shape, but at least as a first step in that direction, would the development of a common market be an alternative that might appeal?

Mr. HORMATS. Let me try my hand at that. I think that the notion of closer economic ties among the three countries of North America is certainly in our common interest. But it is something that probably must be developed over a period of time in an evolutionary way, given some of the sensitivities on the other side of our northern and southern borders.

There is first and foremost among those two countries a concern that we want closer economic ties in order to gain greater control of their energy resources. And while that is not behind the proposals the President put forward in the campaign, it is something which gets a great deal of attention periodically in the press in both Canada and Mexico.

There are, however, a number of trade areas which can provide opportunities for closer collaboration. The Canadians, for instance, would like to sell more surface transportation equipment in the United States. We would like to sell a lot more equipment to the Canadian provinces in the hydroelectric area, for instance, and in surface transportation as well.

There are a whole host of opportunities we would like to take advantage of in Canada. It strikes me that the best way to proceed to do this is to take a look at limited chunks of the trade tie and try to determine where more liberalization can take place in relatively limited areas and then try to broaden it out from there.

I think it is particularly important that we emphasize in developing this the notion of mutual benefit, that as we proceed, there will be enough benefits for us in terms of increased exports to justify our opening up our market more to the Canadians on that side.

With respect to the Mexicans, several years ago, an agreement was reached with the Mexicans which would have significantly opened up new trade opportunities. But it was predicated on the Mexicans having joined the GATT. With the Mexicans' decision not to do so, a certain potential for increased trade was lost.

There have been a number of discussions to try to revive the notion of closer United States-Mexican trade ties through cuts in tariffs and other steps of mutual interest. That would be one area where I think we could proceed with the Mexicans. But it will take time, and it will have to deal with the sensitivities the Mexicans have on these issues.

Mr. BALE. Mr. Chairman, I might add to that that the administration in the summer prepared a report on the desirability of engaging in a North American free trade area under the Trade Act of 1979, which mandated that report. And I think in addition to the comments Mr. Hormats has just made, that one has to point to the difference in structures that one currently sees in the North American economies. The Mexican per capita GNP is only one-seventh that of the United States. And in Canada you have a level of output similar to that of the United States, but a different orientation in the economy—in trading patterns, a much greater dependence upon the United States, a much greater resource dependency and a weaker manufacturing sector.

And I think, in addition to these sensitivities, which grow out of their proximity to the United States there are certain differences in

stages of development, which preclude, at least for the moment, a rapid push toward broad economic integration.

Reflecting these sensitivities and economic structures, there is a difference in their economic policies both in the area of trade, investment, and general macro economic policies that for the moment foreclose anything except perhaps, as Mr. Hormats has indicated, a sectoral approach toward achieving fair trade.

And, of course, we do have a commission that was just set up with Mexico to explore certain areas including computers, automobiles and a number of other product areas. And with Canada, discussions are always going on: surface transportation, energy, a number of industrial product sectors.

So one sees the selective process perhaps in this area working successfully through increasing the number of agreements we have among ourselves. But the giant leap into a free trade area is something I think the President sees and the administration recognizes as currently foreclosed by the obstacles I have just discussed.

Mr. WALDMANN. Mr. Chairman, there is one other little footnote to add: I think the President demonstrated by meeting with both the Prime Minister of Canada and with President Lopez Portillo of Mexico early on in the administration that he considers our two neighbors to be our most important trading partners in evolving this kind of system over time. But it is clearly not something we should impose.

It has got to be an evolutionary process, such as the joint commission on commerce and trade with Mexico, which both Ambassador Brock and Secretary Baldrige cochair, and other institutional arrangements with both Canada and Mexico. These kinds of things, I think, in time could lead to the kind of open trading relationship you mentioned.

The CHAIRMAN. Of course, I am very well aware of the sensitivities of both countries. The feeling that perhaps there is some ulterior motive on the part of the United States.

On the other hand, I think it is clear that, given the kind of resources that the three countries together have cumulatively and collectively, that the proper and coordinated management of these resources could be beneficial to all three countries. And while we may have to approach this concept slowly and delicately, I think it is worth doing.

But in the meantime, we are getting into situations that are going to provide irritants to this whole process, are going to make it harder. Let me give you a specific example of the kind of mail that Members of Congress are getting in this area. There is a company called Brascade. It is a Canadian company. And it has acquired controlling interest in another company called Noranda Mines, Ltd. I do not know whether you are familiar with the case. That is also a Canadian company.

EXCLUDED AMERICAN SHAREHOLDERS OFFER TO BUY

Now, in connection with this acquisition, there was an offer to buy shares by Brascade, but it specifically excluded American shareholders from the offer to buy. Leaving aside whether or not this is a good idea, does this violate any agreements we have or any understandings of this kind?

Mr. LELAND. The basic concept of national treatment, which is a very broad one, Mr. Chairman, I think is something we have to look at in all of these cases. You certainly could not say it did not violate it.

The concept that you are going to treat American investors in any sense in a second-class way is a primary concern. National treatment is the basic concept we think we have to uphold. I think, as Bob said in his statement, we have got to support our businessmen and investors abroad. We are happy that they go abroad but we must back them up if problems arise where they are not fairly treated.

The CHAIRMAN. Is there any jurisdiction for the SEC or the FTC in a question of this sort?

Mr. LELAND. I would think that there possibly would be. If it is on the American market, there certainly would be with the SEC.

The CHAIRMAN. I might refer this kind of inquiry to you for a more specific look, some of the questions that are raised. But I think it is useful for everyone to know and to make some public record of the fact that these kinds of irritants are increasing in number and cannot help but make the climate more difficult in moving along a positive path, as you have suggested.

Mr. WALDMANN. Mr. Chairman, I was just handed a note that, in fact, we have had some discussions with the Noranda people on this particular matter, and I suppose we are exploring the possibilities. But we would certainly be glad to respond to your question in more detail.

The CHAIRMAN. It would be helpful to me if you will keep us advised as to how that progresses.

STATUS OF THE MODEL BILATERAL INVESTMENT TREATY

What can you tell the committee about the status of the model bilateral investment treaty?

Mr. BALE. Mr. Chairman, that treaty has been in the works for a period of about 10 to 12 months. There was an earlier effort in 1979 with Singapore based upon an earlier model to negotiate a bilateral investment treaty.

The treaty that we are putting together has four basic elements: National treatment on entry and for established enterprises, conditions for the free repatriation of capital and earnings and dispute settlement and a provision for losses and damages under conditions of war. And the treaty is in its final stages of clearance among the agencies.

It is a rather new effort for this administration. It has taken a bit of time in putting it together. We are at a stage where soon we will begin negotiations with several countries on the bilateral investment treaty with an aim of completing those negotiations quickly and establishing a series of these treaties with, primarily, developing countries.

So we are in a final development stage. In fact, I expect within the next few weeks that we will begin consultations with one or two countries. We had earlier indications of interest from the country of Egypt in such a treaty. There are also possibilities in the Caribbean and Asia and even a country or two in Central and South America.

The CHAIRMAN. You say the model has been in the works.

Mr. BALE. [Nods affirmatively.]

The CHAIRMAN. I had been hopeful you might get it out of the works today, but I hope you will press on with it.

Mr. BALE. We appreciate your interest in this. I think that we have simply a clearance process here which has to be gone through. And we have received, by the way, a number of recommendations and comments from the private sector, both lawyers and businessmen who have made specific recommendations which have also been helpful to us. But at the same time, it has required a bit of time to give these recommendations careful consideration and selectively incorporate them into the model.

The CHAIRMAN. Of course. I am sure you will not take it personally if I say I get very discouraged when I hear phrases like "clearance process." That has a tendency to drag on.

ECONOMIC PROSPECTS FOR DEVELOPING COUNTRIES

Mr. Leland, would the World Bank or the IMF or other regional multilateral development banks consider the negative effects that performance requirements produce when reviewing the economic prospects for developing countries? Is that one place in which some leverage could be applied?

Mr. LELAND. It certainly is, to some degree. Although I would have to say I do not think it is the primary place that it would be, Mr. Chairman.

Insofar as their distorting things, it is an element to be looked at when you are making a loan. If there are requirements which are really discouraging investment, and keeping it out, the ability to borrow capital is obviously a point of leverage that the bank can use.

INVESTMENT CONTROLLED BY A FOREIGN GOVERNMENT

The CHAIRMAN. I know that you are under some time pressure, but let me ask you a couple more questions. What is the administration's view of direct foreign investment in the United States as it may be affected by different factors, varying factors—let us say, investment controlled by a foreign government? That is a rather pertinent subject right now.

Mr. LELAND. It certainly is.

The CHAIRMAN. We face the prospect of a nationalization program in France. And while again a sovereign nation has the ability to adopt any policy it wants, the consequences of that policy may affect other countries; in this case, French investment in the United States.

Mr. LELAND. Well, as I said in my opening remarks, this is one of the very important areas that we are looking at. We do look upon foreign government-controlled investment as something different than normal private-sector investment. There is no question of that. How you should treat it is another question.

The CHAIRMAN. You are not saying it is better or worse at the moment; you are just saying it is different.

Mr. LELAND. Exactly. I think I would be unlikely to say it is better, so I would say it may not be worse. What you are dealing with is

the question of the private sector and profit motive, the objectives that are there and the fact that a Government investment may not have exactly the same objective.

Again, though, you cannot make generalizations, because it may depend very much upon the sector. It may depend upon the type of investment; it may depend upon the policy of the investors.

On the specific French case, we are concerned and are still reviewing a purchase by Elf-Aquataine of Texasgulf. That purchase was instigated partially by the Canadian NEP because of Canadian prohibition on the transfer of assets of France in Canada. So that element has to be looked into when you have two governments involved.

In addition, you have the French nationalization programs. We have to look at the effects of nationalization on companies that will now become French Government-controlled. We are reviewing that. Likewise, we are reviewing also how our businesses are going to be treated in France under circumstances, where you have strong government involvement. This is where you get into question of reciprocity. If we are going to be very favorable to them, then we want to make sure they are favorable to us.

The CHAIRMAN. Before we get to reciprocity, on the question of nationalization, you would not foresee that you would want to run that investment out of this country simply because it had been nationalized?

Mr. LELAND. No such conclusion has been reached; no. But on the other hand, it is now a different animal. I mean it is something that has to be looked at in the same sense as a holding company. From an antitrust standpoint, you look at what impact that has because you have a new owner.

We have had several discussions with the French Government. Secretary Regan and I have met with the Minister of Finance, Mr. DeLors, and he is very much aware of our concerns with nationalization and changes in ownership.

You really have two issues. One, the issue of companies in the United States which are wholly owned, which is one issue which we have to look at.

Another is the situation where you have U.S. partners who now find themselves with a new partner, the French Government. Other governments, the Germans, the French, the Swedes, and the Swiss all have similar type problems. The Government has to find out what the particular businesses are interested in doing and then determines the impact on the U.S. economy and on the United States in general.

The CHAIRMAN. With the fifes and drums of the anniversary of the Battle of Yorktown still ringing in our ears, we think of the long association we have had with France and the fact that it is a comprehensive relationship, it is not just a military alliance, it is not just a diplomatic arrangement. It involves economic ties as well as political and military ties.

I think it does give us a lot to ponder. And the fact that there is an interrelationship on the economic level, with French investment in America and American investment in France, is a factor strengthening those ties. And I think we have to approach the effects of nationalization very carefully.

But it does have an impact. The largest single investment of private capital in the history of the State of Maryland is a French investment. And the fate of that investment, exactly how that is going to spin out, is of great importance to people, individual Americans, aside from this lofty international policy question.

These are workingmen and women whose futures may depend upon it. So I am interested in how the administration will look at that variable.

Then, of course, there is the variable that you mentioned, reciprocity, and how that affects the administration's view. And there is the variable of investment, say, from the OPEC countries into our energy sector, which is another variable.

Mr. LELAND. We are trying, Senator, to take all of that into account. I think you have put it very well. You have, in a lot of these cases, competing and possibly balancing interests. Obviously, when people invest in your economy, they have an interest in your success.

On the other hand, a government may often make a decision because of concerns about what to do with a company or its employees that is not based upon economic motives; deciding instead to do something if it creates more jobs in France or Britain, even though it might not be economically perfect.

There are competing objectives that one has to look at on a case-by-case basis. Sectors may make a difference. I mean it may be different for energy, manufacturing, or retailing.

OPEC DIRECT INVESTMENT

The CHAIRMAN. Let us look at these two things very briefly, and then I know you must leave.

How much OPEC direct investment is there in the United States?

Mr. LELAND. OPEC direct investment in the United States is very low even if you include the proposed investment in Santa Fe. However, the investment in Santa Fe will substantially increase OPEC investments in the United States.

The CHAIRMAN. There is this feeling in the country that the Arabs have bought everything.

Mr. LELAND. I know. But the statistics do not show that. The data show about $300 million worth of direct investment. There are sizable portfolio investments; that is, investments of less than 5 percent ownership.

A lot of people assumed the Arabs were going to come in and buy everything. In the area of property you did get some substantial properties changing hands; and as a result people thought they were buying everything.

The CHAIRMAN. Visible properties.

Mr. LELAND. Well, apartments in New York, San Francisco, or Chicago. These represent individuals making investments which because of their size may not show up in the direct investment figures.

The CHAIRMAN. How does the administration feel about more direct OPEC investment?

Mr. LELAND. That is one of the issues we are looking at. But it is not really OPEC investment, as such, it is Government controlled investments generally. Our basic policy is for an open attitude toward

investment. But you must look at where that investment is going and what impact it is having.

Is it in property, energy-related or defense-related industries, or is it coming in and saving a declining business? I really think it is difficult to make generalization except to say that we think foreign investment is a good thing. It helps our economy. It recycles some of the funds that they have, and it gives them an involvement in the success of our economy.

"AUTHORITY"

The CHAIRMAN. You mentioned the Santa Fe. If you should decide, for some reason, the Kuwaiti acquisition of the Santa Fe was not a good idea, do you have the authority today to block it?

Mr. LELAND. It depends upon what one means by "authority." I think we have the authority to make recommendations in several ways. First of all, the antitrust laws might be laws that apply in a case like this.

The CHAIRMAN. But you, sitting down there at the Treasury Building, cannot sign a document and say, "This shall not pass"?

Mr. LELAND. No. What I can do, I think, is when it is a government investment on a government-to-government basis—and I think Bob from the State Department and the others would agree—if one government says to another government, "We are not receptive to this investment, and we think it is not in our interest," I would think any government would be very reluctant to go through with that investment.

But you are right, the issue now—and that again is one of the things I said we are discussing—whether we should have some more automatic authority.

The CHAIRMAN. But today it depends upon persuasion and influence and atmosphere and climate.

Mr. LELAND. And application of other laws. If, in looking at it, we feel there is an anticompetitive aspect that might have an antitrust implication and the Antitrust Division agrees, they can bring an action and that stops it very quickly.

REPRESENTATIONS CONCERNING THE NATIONALIZATION PROGRAM

The CHAIRMAN. Just a word on the French question. What representations has the U.S. Government made to the French Government concerning the nationalization program?

Mr. LELAND. We have had, as I said earlier, ongoing bilateral consultation. I have another meeting on the investment issue in a couple of weeks with people at my level.

The CHAIRMAN. What has gone on in those consultations? Have you laid down any guidelines or rules? Have you said to them——

Mr. LELAND. Well, yes, I think first of all it is their business if they want to nationalize. That is their own internal decision. Our concern is, one of adequate compensation, which is both a matter of international law and the treaties we have with France. So the first thing we are concerned about is adequate compensation. In this case, the French Constitution has a requirement for adequate compensation both domestically and internationally.

But we are watching it, too. We want our companies to be treated fairly in this matter.

Also, we will be involved after consultations with our own investors as to what they would like to see us do. We have set up an ongoing dialog with the French to express our concerns and to assure our firms are treated fairly. For example, if people do not want to end up being partners with the French Government will the French Government give them an alternative? They have indicated they will. But it is something we will have to closely watch.

The CHAIRMAN. What would you expect would be the effect of nationalization on future U.S. investment in France?

Mr. LELAND. Well, that is a hard question. I would have to know what the effect of nationalization would be on the French economy. That I would rather not get into. But it is our view it will not be particularly beneficial to the French economy and they will have a lot of problems. Their inflation rate is already going up. It is costing them a lot of money.

The CHAIRMAN. So they are doing some other things besides the nationalization, the 35-hour week and that kind of thing.

Mr. LELAND. There may be things that make it less receptive to investment. But I think the answer is investing in France has never been the easiest thing in the world. An open market like the United States has never been provided in the same fashion with France. You have to get permission of the French Government to invest in France and often requests languish. This has been true for years.

The CHAIRMAN. Mr. Bale's draft is awaiting clearance?

Mr. BALE. It is a process that exists everywhere; is it not? [Laughter.]

Mr. LELAND. But in this case, it is a method to say "No." In the case of Mr. Bale, hopefully, it eventually emerges. But in the French case, it just sits and you never know what is going on with it.

So what we are trying to do now is to make sure that if we are going to be receptive to the French investment, they will be receptive to ours. And this is not just in the investment area, this is in access to credit. Are the nationalized industries going to be preferred over the non-nationalized to such a degree that it discourages investment in France? This is something that we are very seriously discussing with them.

The CHAIRMAN. I believe at the present time French investment in the United States is something on the order of magnitude of $4.5 million, which is triple what it was just a few years ago. What do you think the nationalization will do to the rate of investment from France? And what will it do to the operation of American subsidiaries of French companies?

Mr. LELAND. Well, much of that increase is attributable to Elf-Aquataine's large purchase of Texasgulf. I think that doubled the level of French direct investment in the United States. With regard to French investment in the United States by the public sector, the French are not going to want to be the export capital.

With regard to subsidiaries of French companies it will depend if you are talking about nationalized companies. That is the issue we have to make clear, how are they going to treat those subsidiaries. If it is non-nationalized companies, I would not imagine there would be any great change.

The CHAIRMAN. Mr. Leland, we appreciate your being here, and we are happy to have you stay as long as you can. But if you feel you must go——

Mr. LELAND. I have 5 more minutes. I want to hear what Mr. Hormats and Mr. Waldmann have to say.

FOREIGN PERFORMANCE REQUIREMENTS

The CHAIRMAN. Mr. Hormats, how does the administration intend to coordinate its efforts to reduce foreign performance requirements with efforts to encourage private direct investment in developing countries?

Mr. HORMATS. One of the major objectives we have is to try to put together internationally a broader consensus to reduce the incidence of investment performance requirements before they become too widely spread. At the present time there are two neighboring countries who seem to be major practitioners of the art of investment performance requirements in the developing world: Brazil and Mexico. There are a number of others which this study indicates use them as well.

The CHAIRMAN. Brazil and Mexico are two fairly critical countries.

Mr. HORMATS. Yes; they are. Brazil is not listed here. But you have India, Nigeria, Libya, Mexico, Venezuela, and Peru, where the incidence of performance requirements, according to the Commerce data, is relatively high. On table 4 there are others. These are certainly countries of some significance, for the most part, to us.

One of the difficulties, Mr. Chairman, is that there is no real international agreement, understanding, or framework within which these can be dealt with. And the first step in this process is to try to convince these countries, either bilaterally, as we are doing with the Mexicans on the automotive decree, or multilaterally in such fora as the GATT, where we have put this forward in the context of the Consultative Group of 18—which is a steering group of the GATT—to try to at least underline the implications of this for the international trading system.

Quite frankly, the degree of progress is very limited at this time. Many of these countries regard these requirements as justifiable in terms of their efforts to increase the use of local components or increase exports. And therefore, they are very reluctant to subscribe to any international rules which would limit the use of these things.

We are going to make a major pitch about this and will continue to do so in the GATT. It will almost certainly be the sort of question we would take up at the GATT ministerial meeting, which will take place probably in November of 1982. It is something we have discussed in the context of the OECD and, as I say, bilaterally with Mexico and other countries.

I think one of the points where this will be linked to the overall question of supporting investment in the developing countries is in whether or not we link Exim financing or OPIC support to the policies of these countries in the area of investment performance requirements.

The CHAIRMAN. That is really what I am trying to get at. How are you going to coordinate the overall efforts of the Government? For instance, in the New York Times on the 20th of this month there was

an article which headlined, "U.S. to Send Aid Teams to Scout the Third World. The Reagan administration today outlined how it intended to give private enterprise a large role in American foreign aid." In other words, it went out looking for investment opportunities.

Mr. HORMATS. This is the trade and development program, I assume—the TDP.

The CHAIRMAN. But how are you going to coordinate that with an effort to reduce performance requirements?

Mr. HORMATS. One of the problems—the internal coordination—would simply involve AID plus the agencies here plus probably Exim and OPIC. The problem in linking Exim financing to performance requirements is that these are programs designed to benefit the American exporters.

So while I have heard proposals for cutting off Exim financing to a country which imposes performance requirements, the result would be that it will probably hurt the American exporter more than it will hurt the country that imposes the performance requirements.

The CHAIRMAN. Is this where we devise the phrase "shoot yourself in the foot"?

Mr. HORMATS. That is right. Similarly, OPIC is obviously designed to help the developing country that gets the investment, but it helps the American investor by providing him with the necessary insurance. I assumed you were trying to get at that point—I have also, having thought it through, developed a more cautious attitude toward that type of linkage.

SECTION 301 OF THE TRADE ACT

The CHAIRMAN. There has been some suggestion that section 301 of the Trade Act be employed as a response. What are the pros and cons of a more explicit statutory provision regarding investment cases, and how do you think business and labor can have much confidence in the remedies under section 301 when there really has not been much relief afforded, say, along the Canadian border?

Mr. HORMATS. My theory about 301 is you had better know what provision of the GATT or other international instrument you are going to use when you embark on the process, because 301 is essentially an internal legal process.

To seek an international remedy, one is probably going to have to use some section of international law or the GATT. And it strikes me that it may be satisfactory for a particular firm to embark on 301, but we as a government ought to have a pretty good idea, if that 301 process comes out in support of the firm, whether or not we have a viable provision at the GATT that we can use to seek redress. If we do not, then we have a 301 process which has culminated in an affirmative judgment for the firm but no recourse under international rules.

I tend to think there are, in performance requirements, violations of the subsidies code of the GATT, because, in effect, particularly when you are doing these things in ways which force out exports—and part of these, of course, do that—you are, in effect, artificially inducing greater amounts of exports. And that might well be pursued

under the subsidies code of the GATT. There may be other provisions of the GATT as well which apply to them.

So I would not discourage the 301 process necessarily, but I think when we do it we ought to know we have a good case, a winnable case. And we ought to know there is a provision of the GATT we can use to follow it up internationally to achieve success.

The CHAIRMAN. That leads me to turn to Mr. Bale and ask him the question of whether the administration is going to file a complaint against Canada under GATT.

Mr. BALE. Mr. Chairman, the administration is looking closely at the information which has been gathered through the Commerce Department mailout of questionnaires on the operations of the Foreign Investment Review Agency. We think, in addition, as Mr. Hormats has indicated, that there are GATT articles which the operation of FIRA contravenes. There is article 3 on national treatment.

We think also in the implied quotas of investment performance requirements, there are certain violations of article 11, I believe it is. And the problem we have run into, the problem we are running into a little bit in this area is the amount of information we are gathering for the possible action.

As Mr. Hormats has indicated, we need an international sanction for some of these actions unless we are to risk a possible justified under the GATT retaliation by a country against whom we take action in a 301 case. So at this point I can only say that the administration is looking very closely at the matter.

We have a process of information gathering which is absolutely necessary in the first instance to enter into such a process. We have not formally engaged the 301 mechanism, but we are in a preliminary examination state, in an information gathering state, for such an eventuality. If we have the proper information, which has to be good information, to initiate such a case which will obviously raise the temperature between the two countries.

MULTILATERAL INVESTMENT INSURANCE PROGRAM

The CHAIRMAN. The President has referred to the possibility of a multilateral investment insurance program. That raises a question of what will this do that OPIC is not doing. What is the advantage of such a program?

Mr. HORMATS. It can do a number of things. One, OPIC is a national insurance firm for investments abroad. The virtue of a multilateral insurance agency is that it could permit a pooling of the risk guarantees among a number of countries. In effect, an expropriation takes place, the guarantee is backed up, not just by one national insurance agency but by capital or guarantees spread more widely among a number of participating countries and perhaps the World Bank.

Two, the fact that it is linked to the Bank, I think, will in itself discourage expropriation because expropriating and then having an instrument of the Bank participate in the process of adjudicating the repayment, if that is the case, would, I think, be bothersome to a number of countries who do not really want to take on the Bank.

And, third, one particular virtue is that the OPEC countries—there is a gulf-type of OPIC—could take advantage of that type of institution as a political risk guarantee of some of their investment. And that might induce them to invest greater amounts of money directly in the developing countries.

INTERNATIONAL FINANCE CORPORATION

The CHAIRMAN. A somewhat related question is the expansion of the International Finance Corporation.

Mr. HORMATS. The IFC. Well, we have thought about that. The IFC now has a very vigorous new head, and is working more actively to be a catalyst for private investment. At this point there has not been a request for new funds.

I think the real objective for the moment for the IFC is to play a more aggressive role and to use a relatively small share of its funds combined with a considerably larger share of private funds to induce greater investment in the developing countries. That is really what we would like to see it do at this point.

The CHAIRMAN. One of the philosophical questions that arises is what the effect of the performance requirements are on the economies of the host countries and whether or not they really achieve what they set out to do.

Mr. WALDMANN. Mr. Chairman, many of the countries which have adopted these policies believe they are achieving what they set out to do. They take many forms, as our report states, and they are a growing phenomenon. It seems to be catching on more and more. So presumably, countries are finding that these achieve their short-run goals.

Whether they achieve their long-run goals is another question. And, as I said in my longer statement, we distinguish between the short-run impacts of those performance requirements which may replace an import or lead to a greater export earning, but in the long run they may make the economy much less attractive as a site for investment and thus tend to diminish the foreign investment or the domestic investment in that economy.

The CHAIRMAN. I think all of us have taken some self-satisfaction this morning—I hope justified—in the fact that the United States maintains a free and open climate in which investment can either come to the United States or can be made by Americans in other parts of the world. We neither encourage nor restrict.

NATIONAL POLICIES ON INVESTMENTS

But our comments have been really directed at the Federal Government, the activities of the Federal Government. And there are still such things as States rights, notwithstanding the events that culminated in Appomattox 100 or more years ago. And the States do, in fact, have various kinds of restrictions.

Are any of them interfering with our national policies on investment?

Mr. WALDMANN. Mr. Chairman, I will respond to that briefly and let the others respond. I do not think they are.

UNITARY TAX POLICY

The CHAIRMAN. How about a unitary tax policy?

Mr. WALDMANN. Well, most of the restrictions which the States have employed in the past go back for decades or even a century, and these are generally restrictions placed to ensure public health and welfare, and to allow the State regulatory processes to work in the banking, insurance, and finance fields.

In the last few years a few States have placed restrictions on the acquisition of farmland by foreign interests, which I think are basically counterproductive. But it is understandable that some States, which are particularly sensitive to the price of farmland and the need to keep a farming community, would be concerned about absentee ownership of farmland. However, very few States have done that.

The States also have significant programs to attract foreign investment. They have offices overseas and they have their own missions to talk to foreign businessmen, to attract new business to the States.

So while they may have some historic restrictions and, in a few sectors some new restrictions, particularly in farmland, they are still very anxious to attract new investment. Thus, the picture is mixed.

I am not really familiar with the legal status right now of the unitary taxation issue. I know there have been some previous court decisions and the matter is now pending before the Supreme Court. And in addition, there is legislation pending, but I do not know what the administration position on it is.

The CHAIRMAN. Do you want to add something on that, Mr. Bale?

Mr. BALE. Well, not very much. I think you probably have put your finger on a major problem, potentially. We have had visits in our office by major foreign representatives of major foreign companies who are very concerned about the unitary tax policy which taxes a per operations rather than operations within the boundaries of the State in which they are registered.

The CHAIRMAN. It is a kind of performance requirement on how you keep your books, how your accountants perform.

Mr. BALE. That is right. The argument on the one hand is that this is perhaps a manageable technique; at least that is an argument I have seen by officials who promote them. It seems to be a spreading practice. California, perhaps, is the one, because of the United Kingdom-United States tax treaty is perhaps the most well known, but there apparently is an association. There is an association of States which used the unitary tax approach, and I think they have to look at it very carefully.

I know Ambassador Brock and I chatted about this about a week ago, and he was very much concerned that Government does not have a view on this. It is a delicate political matter, of course. And, of course, we have an issue in the courts at the moment on the problems.

The CHAIRMAN. I raised that subject with some malice of forethought, and I would urge you to all look at a splendid piece of legislation which is now languishing in the Congress.

Mr. WALDMANN. Is it awaiting clearance, Senator?

The CHAIRMAN. It is awaiting clearance. [Laughter.]

And I highly recommend it to you on this subject. I think it is going to be really a necessary thing. When I say "awaiting clearance," let me say I introduced it first 17 years ago. But someday its time will come, and it might just be on your watch. So look at it carefully.

Mr. BALE. It seems that the progress of the States adopting these, perhaps it will be more difficult.

The CHAIRMAN. Of course, it touches upon the question of States rights, and the States during those 17 years, have vigorously resisted it on the theory that it would some way diminish State revenues. I do not believe it would. And it is interesting to me that at intermittent hearings over the years the resistance of the States has decreased gradually. But the international interest has consistently increased. So I think it is a proper subject of some concern at your level.

LOCAL CONTROLS

But Mr. Waldmann suggests that States apply local controls of various kinds. Should we respond as far as local controls in other countries are concerned by, let us say, local controls on automobiles sold in the United States as sort of an indirect approach? Mr. Bale is reacting very promptly to that.

Mr. BALE. No; the administration does not support local content for imported products, whatever they are. That would be counter to our posture.

The CHAIRMAN. You think that is too patently an indirect way to do what we have forsworn otherwise?

Mr. BALE. That is right. And very costly as well. I do not think it is consistent with our anti-inflationary goals. The prices of automobiles are already, according to the latest issue of the Wall Street Journal, too high for the market to bear. And I think employment in the long run would suffer. We would suffer a precedent for possible use in other areas that I think would be damaging.

The auto sector is obviously a seriously affected sector in a world competitive market, but that is not the answer.

The CHAIRMAN. Not long ago I participated in a panel at the American Enterprise Institute in which we were discussing investment in Japan. There were several Japanese participants. For example, they said anyone can invest in the automobile business in Japan, but then, of course, what you have to do is you just cannot roll your Chryslers out on the dock in Yokohama, you have to have a sales force, you have to have a service arrangement, you have to have a continuous supply of spare parts.

In other words, you need all the infrastructure that is necessary. And anyone can do it, but you have to have all of these other things.

Now, does that affect the climate for direct investment in Japan? Is there that kind of impediment, a serious problem?

Mr. WALDMANN. Senator, we are looking at that precise problem right now. Let me put it in perspective. U.S. direct investment in Japan at the end of last year was approximately $6.3 billion, roughly the same size as our investment in Australia, which was $7.5 billion, a country of much smaller population. And our investment in Switzerland, for example, is almost twice the size of our direct investment in Japan.

We believe that there are a number of barriers, some cultural and some legal, which tend to restrict the amount of U.S. investment potential in Japan. And we are working with the Japanese Government to identify those and to try to remove them.

The CHAIRMAN. So while in theory it is open to investment, in practice it is difficult to do.

Mr. WALDMANN. I think that is correct.

Mr. HORMATS. May I add a thought to that? As you know, in the fifties and sixties the U.S. auto industry invested rather actively in Europe in order to get into the European market. Most big American firms did this. They tried in Japan and were unable, for a whole myriad of reasons, to get in. The Japanese then came somewhat later, and said, "Well, now you can invest."

The point is that the Japanese tend to protect their industries from either imports or investment competition for a period of time until they build up huge economies of scale, and then they say, "Let's have free trade in that sector," or "Now you can come in and invest in that sector."

So it is both a problem of all of the rigmarole you have to go through and a problem of time, because over a period of time they will say, "Well, now you can come in. It is perfectly open." But, of course, they are so powerful and so competitive at that point that it would not really pay very much to come in at this point even if everything were totally free and open.

So it is a double problem, and a very bothersome one, I think, to the American auto companies and others.

The CHAIRMAN. I did not mean to restrict the question to automobiles. That was an example that was fresh in my mind.

Mr. HORMATS. There are some high-technology companies, Texas Instruments (TI), and Hewlett-Packard, for instance, have gone in and done well. But it is a very difficult thing to do, and most firms find it so hard they become discouraged before they try.

DEVELOPING COUNTRIES THAT DO NOT BELONG TO GATT

The CHAIRMAN. Mr. Hormats, let me ask you one final question. What do we do about developing countries that do not belong to GATT, who have not joined the subsidies code? What kind of leverage do we have on them in dealing with the problem of performance requirements?

Mr. HORMATS. The countries that have not joined the subsidies code do not get an injury test. That is the one cost in a trade context of their not joining the subsidies code. If that is the case, and Mexico is a good case in point there, one has to just pursue various bilateral approaches and decide how hard we want to fight and, in particular, what we want to do if we do not get satisfaction.

And we have been pushing. There have been a number of meetings with the Mexicans on the automotive issue. What we have been trying to do with the Mexicans is convince them that, one, it is very troublesome for our overall relationship with them to have these performance requirements, for instance, on autos; and, two, some of the investment would come there in the absence of the automotive decree, so they do not really need to have something like this because they would get a certain amount of investment without it.

But frankly, we have not crossed the bridge of what we would do if, after a reasonable period of time, our importunings and urgings were disregarded and the problem continued. And that is a bridge we are going to have to cross.

It is very bothersome, particularly for American labor, to have jobs be attracted to other countries purely because these countries insisted

on a certain amount of local content or insisted upon a certain amount of exports out of a given factory or a given sector.

And I think it is a highly legitimate thing for us to take up with these countries. Unfortunately, if they do not join the GATT, we have to do it bilaterally. Maybe it is fortunate or unfortunate, but that is the reality.

And I think what it means is these issues which violate international principles—and it is probably preferable they be dealt with in a multilateral forum like the GATT—simply cannot be because the country is not a part of the GATT. It therefore becomes a very contentious bilateral issue.

But the time has long since passed when the United States can ignore these things. They affect our interests, and we will have to go after them in a very assertive way, first to deal with them and obtain redress; and second, if we do not do it, they will proliferate and the system will be more and more bogged down with them.

The CHAIRMAN. Gentlemen, I thank all of you very much for being here today. Is there anything you would like to add to what has been said?

Mr. WALDMANN. Senator, I hesitated to comment when you were talking to Mr. Leland before, because I knew he had to leave. But I would like to add one small point to the discussion you had about the inward investment problems and the review of those investments.

We, I think, should consider seriously the implications of two kinds of inward investments which do pose problems. One is the investment from a nonreciprocating country; that is, a country which does not give us the same kinds of rights, privileges, opportunities and redress, that is, legal protections.

The second involves those cases of unfriendly takeovers of U.S. companies where there is, in fact, some kind of bidding process going on between two companies for a third company. If one of those bidders is, in fact, a nationalized company or is supported by its foreign government, then that does change the rules of the game a bit. I think we have to look at those situations more carefully. And some of the cases Mr. Leland mentioned are, in fact, of that nature.

In the friendly takeovers—that is, where there is an agreement between the U.S. company and the foreign company—whether it is a nationalized company or not, there may be less need for us to intervene.

The CHAIRMAN. But where there is some conflict?

Mr. WALDMANN. Where there is a conflict and where one of the parties has a clear advantage because of the deep pocket of the foreign government which supports the nationalized bidder, then I think we have to take that into account.

The CHAIRMAN. Once again, thank you all for being here. The record will be held open for several days in the event that you have any further thoughts or any additional information you want to add.

Mr. WALDMANN. Thank you very much, Senator.

Mr. BALE. Thank you.

The CHAIRMAN. The subcommittee stands in recess.

[Whereupon, at 11:30 a.m., the subcommittee adjourned, subject to call of the Chair.]

APPENDIX

INVESTMENT POLICIES
IN SEVENTY-THREE COUNTRIES

A SURVEY

SEPTEMBER 28, 1981

Price Waterhouse & Co

INVESTMENT POLICIES IN SEVENTY-THREE COUNTRIES

A SURVEY

This report presents the results of a 73-nation survey of non-tax restrictions on inflowing foreign direct investment in the following categories:

- o Ownership Restrictions
- o Exchange Controls
- o Repatriation or Remittance Restrictions
- o Employment Restrictions
- o Local Material Content Requirements
- o Other Restrictions

In addition, the report also presents information on Subsidies and Other Incentives to Foreign Investment, if any, applicable to each country.

The report is based on data supplied by Price Waterhouse offices located in the 73 countries covered by the survey, in response to a request made to them on July 31, 1981, by the U.S. firm of Price Waterhouse. To our knowledge, this is the most comprehensive and up-to-date summary of investment policies in other countries currently in existence.

We undertook the survey for two principal reasons:

First, we wished to call attention to the need for the United States government to place greater emphasis on international investment policy--before a crisis develops.

Second, we wished to develop a timely base of information to assist United States policymakers in the implementation of an effective international investment policy that will ensure national treatment of United States investments abroad.

We hope our survey will help our policymakers formulate an aggressive program to promote, to encourage and to facilitate United States direct investment abroad, and that it will prove useful and informative to businesses pursuing such investment.

Price Waterhouse & Co.

September 28, 1981

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NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: ARGENTINA

INTRODUCTION:

Except for certain periods, Argentina has traditionally welcomed foreign capital and expertise. It is the intention of the present Government to establish and maintain conditions attractive to foreign investors, as foreign capital and expertise are considered essential to Argentina's development. To this end, certain amendments have recently been introduced to the Foreign Investment Law which establishes the rights and obligations of foreign investors. The technology law was likewise amended to simplify and accelerate the related procedures. The trend in the past few years has been to ease exchange controls, although their implementation is always subject to the evolution of exchange reserves. Locally-owned businesses are given priority in competition for government contracts in the construction and consulting fields. There is no discriminatory treatment against foreign investment from any particular country.

OWNERSHIP RESTRICTIONS:

Although foreign investors are not prevented from investing in any particular sector, prior Government approval is required, under penalty of being legally null and void, when:

- o Investments are made in restricted sectors, i.e. national defense and security, certain public utilities and services, radio and television, newspapers,

magazines and publishers, energy, education, financial entities and insurance, mining, and others.

- They exceed US $5 million.

- The investor is a foreign state or government institution.

- The investment is made in the form of acquisition of capital participations or underlying assets owned by local investors. Special requirements are set out when a transfer of majority ownership to foreign investors takes place.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through financial entities authorized by the Central Bank to deal in exchange.

Currently no Central Bank approval is required to remit profits, royalties, or interest on loans, or to repatriate capital. However, only those investors registered under the Foreign Investment Law will be allowed to remit profits and to repatriate capital if an exchange control is imposed on these remittances.

A "commercial" market rate which is set daily by the Central Bank is applicable to imports and exports, while a "financial" rate, which floats in accordance with supply and demand, applies to all other exchange transactions, including freight and insurance on imports and exports.

Terms and interest payable on foreign loans can be freely agreed by the parties.

Future exchange contracts may be entered into for financial loans in accordance with specific Central Bank regulations.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Only foreign investors registered under the Foreign Investment Law would be allowed to remit profits and to repatriate capital in the event of exchange control limitations.

Registered investors' remittance of profits has no established limit, but amounts remitted in excess of 12 percent of the registered capital in foreign currency are subject to a special remittance tax. The same applies to the repatriation of capital in excess of the registered amount.

Registered capital cannot be repatriated until three years have elapsed.

Those making transitory investments made for the execution of contracts for less than a 5 year period may opt to register under the terms of the foreign investment regulations or to submit themselves to the prevailing exchange controls, if any.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on a temporary basis.

LOCAL MATERIAL CONTENT REQUIREMENTS:

It is mandatory for state agencies, government or quasi-government companies to purchase only goods of national origin at a fair and reasonable price if compared with imported goods, notwithstanding the foreign ownership of the local supplier company.

OTHER RESTRICTIONS:

Transactions between a foreign parent company and its local subsidiary or branch are valid, if agreed upon on an arm's length basis. However, intercompany loans are subject to Central Bank control, and prior government approval is required for inter-company technology contracts. Non-compliance with these requirements implies discriminatory tax treatment only.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

In general terms foreign investors are ensured rights and obligations equal to those granted by Argentine laws to national investors, subject to the provisions of foreign investment regulations and other provisions established under special or promotional regimes.

However, exemptions or allowances, such as those granted for industrial or mining promotion, will not be applicable to the extent that they represent a benefit to a foreign treasury.

In August, 1981 the Government announced that incentives will be granted to foreign investors to encourage their participation in certain sectors. The details of this proposal have not yet been made known.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: AUSTRALIA

INTRODUCTION:

The Australian Government welcomes foreign investment with a policy that seeks to ensure Australian participation in the ownership and control of industries and resources, to the extent appropriate in the particular circumstances of each proposal. The Foreign Investment Review Board advises the Government on foreign investment matters and deals with applications for foreign investments in the following categories:

- Proposals falling within the scope of the Foreign Takeovers Act. These include:
  - any acquisition or issue of shares which would result in or increase a substantial interest in an existing Australian company;
  - any acquisition of an Australian business by the purchase of assets;
  - any agreement (including alteration of Articles of Association) that would give a substantial foreign shareholder in an Australian business rights to representation on the board of that business; and
  - any arrangement relating to the leasing or the granting of other rights to use assets of an Australian business or to participation in the management or profits of an Australian business.

  It is the practice of the Government not to intervene, except in special circumstances, in proposals where the total assets of the target company or business are less than $2 million.

- Investment proposals not coming under the Foreign Takeovers Act but falling within the following categories:
  - all proposals to establish a new business or project, irrespective of size, in industries subject to special restrictions--namely finance, insurance, the media, civil aviation, uranium and activities relating to uranium;
  - direct investments by foreign governments or their agencies (i.e. excluding portfolio investments or investments related to their official representation);
  - other proposals to establish new businesses, where the total amount of the investment is $5 million or more (including diversification into activities not previously undertaken directly in Australia and new projects in mining or other natural resource industries); and
  - proposals to acquire real estate valued at $350,000 or more.

Even if a foreign investment proposal is not examinable by the Foreign Investment Review Board, in most cases it will reqiure separate foreign exchange control approval from the Reserve Bank of Australia.

OWNERSHIP RESTRICTIONS:

Private enterprise generally is excluded from the operation of electricity generation; postal, telephone and telegraph services; and public railways.

It is Australian Government policy that foreign interests should not be permitted to carry on banking búsiness in Australia, or allowed to acquire interests in existing Australian banks.

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Foreign investment in broadcasting and television is governed by the Broadcasting and Television Act, which provides that no single overseas shareholder shall hold more than 15 percent of the issued capital of a company holding a broadcasting and television license, and that not less than 80 percent of the issued capital of such a company must be beneficially owned by Australian residents.

Specific guidelines exist for Australian participation in natural resources projects, including uranium and other mining activities, agricultural, pastoral, fishing and forestry operations. In these areas, a new business or project involving investment by foreign interests will only be allowed to proceed if it has a minimum of 50 percent Australian equity and control, or a minimum of 75 percent equity and control in the case of uranium mining projects. Individual foreign portfolio shareholdings of less than 10 percent in an Australian uranium company are likely to be disregarded in calculating the 75 percent equity test. In respect to minerals the equity and control requirement is not imposed at the exploration stage, but at the development phase.

EXCHANGE CONTROLS:

Exchange control is administrated by the Reserve Bank of Australia, with limited authority delegated to the trading (commercial) banks.

Exchange control approval is required by Australian residents for the buying and selling of foreign currencies, for all payments to non-residents and for contracts with non-residents (other than contracts for the purchase of goods). Approval is also required for the allotment of equity capital in Australian corporations to foreigners and for the sending of securities out of Australia.

In general, exchange control approval is granted without discrimination between currencies, countries or nationalities. However, some transactions and contracts with designated overseas countries require prior clearance from the Commissioner of Taxation stating that tax avoidance or evasion is not involved.

There are no exchange control restrictions as such for the receipt of equity capital, borrowings and technology agreements between Australian and foreign enterprises. However, details of such transactions, including the written agreements entered into would need to be presented to the Reserve Bank of Australia as a matter of course in seeking exchange control approval.

Approvals from the Reserve Bank of Australia of applications from foreign investors that satisfy exchange control requirements would be subject to any necessary approval being obtained from the Foreign Investment Review Board in accordance with the Australian Government's foreign investment policy.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no specific rules and limitations regarding the transfer out of Australia of profits, dividends, license fees, capital and similar funds belonging to foreign investors, except that payments to non-residents which are approved for transfer overseas must be remitted within specified periods. Assuming exchange control approval for a transaction which originated the flow of funds has been obtained, permission for repatriation of funds should be given as a routine approval, subject to the economic policy of the Government at the time in respect to foreign currency movements and provision for the payment of tax liabilities.

Government and similar guarantees against inconvertibility are not available, and the Reserve Bank of Australia does not make commitments in advance for the conversion of Australian currency into other currency.

EMPLOYMENT RESTRICTIONS:

Entry into Australia may be accomplished through a visitor's visa, a temporary residence visa, or by way of permanent resident status.

A visitor's visa is normally granted for an initial period of three months but can be extended without difficulty for a further three months. The holder of a visitor's visa is not entitled to work in Australia.

A temporary residence visa authorizing an initial stay of up to four years will generally be granted to persons who are appointed to provide overall managerial direction to a substantial enterprise in Australia. Extensions of stays beyond four years are considered for persons in this category in the light of prevailing circumstances.

A temporary residence visa authorizing an initial stay of up to two years may be issued to executives (other than top management personnel), professional, technical and other specialist staff having particular qualifications not generally available in Australia. In some instances applicants will only be admitted on the basis that they will pass on their expertise to local employees.

The holder of a temporary residence visa is entitled to work in Australia and may be accompanied by his or her family.

Prospective immigrants must apply for permanent residence status.

LOCAL MATERIAL CONTENT REQUIREMENTS:

In 1980 the Australian Government enacted legislation giving preference in the procurement of goods for Commonwealth authorities to goods of Australian origin or having an Australian content.

However, in August 1981 the Australian Government announced that the existing policy of giving preference to Australian-made goods in government purchasing will be eliminated, except in respect to certain defense-strategic industries.

OTHER RESTRICTIONS:

Agricultural Quarantine Restrictions

Australian animal and plant quarantine requirements are strict. Prior permission to import animal or plant products is required and should be obtained by the proposed importer.

Environmental Considerations

Proposals of major environmental significance can be subject to the preparation of an envronmental impact statement or to the conduct of a public inquiry.

Mineral Export Controls

Permission must be obtained for the export of coal, iron ore, bauxite, alumina, petroleum and petroleum products, tin, salt, uranium and materials of nuclear significance.

Standards

Mandatory standards exist with respect to product safety, public health and information, and apply to such items as food, therapeutic substances, transport vehicles, clothing and buildings.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT

Certain industries are afforded tariff protection from overseas imports, while assistance in the form of subsidies and bounties is available to encourage the local manufacture of certain products, particularly in the rural industries.

Some assistance is available for new industries locating in regional growth areas, the extent and nature of the assistance varying from case to case and from State to State. Within the agricultural sector, there are price support/stabilization and marketing schemes which have government support.

Export incentive grants and industrial research and development grant schemes are currently in force.

There are no tax incentives designed specifically to encourage foreign investment in Australia, although there are general incentives in the form of special depreciation rates for certain assets and an investment allowance for investment in new machinery and equipment.

Certain apprenticeship support schemes exist to encourage the training and employment of trade apprentices.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: AUSTRIA

INTRODUCTION:

Austria actively encourages investment to set up local manufacturing operations but does not distinguish between foreigners and citizens.

OWNERSHIP RESTRICTIONS:

Direct or indirect foreign ownership of real estate requires prior approval.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange.

Prior approval of the National Bank of Austria is required for all loans from outside.

Investments require a National Bank permit.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Interest on loans must be in compliance with approved loan contracts.

EMPLOYMENT RESTRICTIONS:

Residence permits and work permits are required for foreign personnel hired on either a permanent or temporary basis.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Foreigners may not run most businesses without special examinations and may not work as professionals without specific Austrian University Diplomas.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Substantial subsidies are available to new producing facilities, regardless of ownership.

NON-TAX INVESTMENT RESTRICTION

COUNTRY: BAHRAIN

INTRODUCTION:

Bahrain is eager to encourage foreign investment for any purpose, and particularly if such investment creates additional employment. All investment is welcomed within the general rule that all companies must be at least 51 percent Bahraini owned or, in the case of branches, be sponsored by Bahraini nationals. There is one exception to this rule, which relates to Exempt Companies which may be established with no local participation; however, they are not allowed to conduct business with residents of Bahrain. Such companies have been used as a vehicle for offshore banking and Gulf-wide operations conducted from a base with good communications and no taxation.

OWNERSHIP RESTRICTIONS:

There are no specific restrictions on ownership of any individual company, the general rule is that a foreign participant may own no more than 49 percent of the enterprise. Land can be owned only by Bahraini nationals. In practice certain activities (particularly general trading) are closed to foreign investment, and foreign participation tends to be restricted to areas where special expertise or very substantial capital investment is needed and cannot be provided locally.

EXCHANGE CONTROLS:

There are no exchange control regulations in Bahrain.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There is no restriction on the repatriation of capital or profits, and the movement of funds is unrestricted.

EMPLOYMENT RESTRICTIONS:

Work permits are required for all foreign nationals (and entry visas for most) working in Bahrain on either a permanent or temporary basis. There is, however, no particular restriction on the nationals from any one country being employed, although in practice Arab nationals tend to be preferred.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

There is a general embargo on any companies which have dealings with Israel and who are named by the Israel Boycott Office.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

While there are no financial inducements to invest in Bahrain, it is relevant to note that the open attitude of the government and the excellent facilities and communications actively encouraged in Bahrain make it an attractive place in which to invest from the point of view of Middle East operations in general. For any project considered desirable by the government, every effort is made to facilitate the success of such a venture.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: BARBADOS

INTRODUCTION:

Barbados welcomes foreign investment, particularly where it introduces skills and expertise not readily available locally. The foreign investor would be expected to provide training facilities for nationals who would, in due course, be expected to replace expatriate personnel. A work permit is required to enable an expatriate to work in Barbados. A foreign investor in Barbados is not allowed to hold shares in a local company without obtaining permission from the government. The government regards joint ventures between local and foreign firms, government and foreign firms or a combination of government, local and foreign firms, as the most desirable form of direct foreign investment.

OWNERSHIP RESTRICTIONS:

Foreign ownership is not restricted to minority shareholding participation, but permission to hold shares in a local company or to acquire freehold property must be obtained from the Central Bank of Barbados.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange.

Prior approval of the Central Bank of Barbados is required for transactions involving foreign currency.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investment must be registered with the Central Bank to ensure repatriation rights.

Capital, loans and technology agreements must be approved by and registered with the Central Bank to ensure remittance rights.

Royalty agreements, agreements to provide management services or technical services, and any other agreements or contracts must be approved by and registered with the Central Bank to ensure remittance rights.

The remittance of funds arising as a result of the appreciation in value of assets will normally be phased. The period of phasing is determined on an individual case basis by the Central Bank.

Profits, dividends, interest and other current payments arising from foreign investment are presently freely remittable abroad provided the Central Bank is satisfied that all tax liabilities have been settled.

EMPLOYMENT RESTRICTIONS:

Work permits are required for foreign personnel hired on either a permanent or temporary basis. Work permits are normally only issued when qualified nationals are unavailable.

LOCAL MATERIAL CONTENT REQUIREMENTS:

The government may in certain circumstances require the use of locally produced items in certain enterprises.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Under the provisions of the Fiscal Incentives Act of 1974, an approved enterprise may be granted tax concessions in relation to the manufacture of an approved product.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: BELGIUM

INTRODUCTION:

Government Attitude Towards Foreign Investment - The Belgian Government welcomes foreign investment and provides information to foreign countries in order to advise possible investors of the advantages of establishing an enterprise in Belgium. The Government has created a special service for the sponsoring of foreign investment, and the Belgian embassies and consulates work closely with this service to inform interested parties of the possibilities offered by Belgium.

Special efforts are made to obtain investment in the depressed areas, such as those which suffer through the closing of coal mines (the southern provinces and Limburg) or where, on account of the development of mechanization in agriculture, there is surplus labor. Officially recognized committees have been formed in each province in order to sponsor investment in their areas. In addition, there are intercommunal institutions for economic expansion which aid in the setting up of new industries in their areas by helping in the acquisition of land (generally by expropriation) and the building of plants.

Labor Attitude Towards Foreign Investment - Trade unions are grouped in two main organizations. According to the type of industry, the percentage of workers who are union members varies from 50 to 80 percent. The attitude of the unions toward foreign investment and management tends to be neutral.

OWNERSHIP RESTRICTIONS:

There are no restrictions on foreign ownership except for Belgian national railways and the telephone and telegraph systems which are state monopolies.

EXCHANGE CONTROLS:

In practice, there exists at present freedom of exchange for all purposes. However, particular operations not covered by the general regulations are still subject to the authorization of the IBLC.

The foreign exchange market can be subdivided into two sections, the official exchange market and the free market:

1. The official exchange market deals with the following transactions which must always be settled through a bank: importation and exportation of goods; transportation charges and customs duties; manufacturing, assembling, maintenance and repair charges; commissions and brokerage fees; insurance premiums and indemnities, except life insurance; payments to travel agencies; salaries, wages, pensions and fees; royalties, including technical assistance and related expenses; Belgian and Luxembourg taxes and penalties; share of administrative expenses incurred by foreign companies on behalf of their foreign branches or subsidiaries; payments of dividends, interest and transfer of branch profits.

   Transactions of the types listed above involving more than BF 10 million require prior authorization from the Exchange Control Board. For non-residents, Belgian francs bought or sold on this market are called convertible francs.

2. The free market deals in other transactions such as: bonds and shares; bank notes; share of administrative expenses incurred by a Belgian company on behalf of its foreign branches and subsidiaries; collection of

dividends and interest; and capital investment in Belgium.

For nonresidents, Belgian francs bought or sold on this market are called financial francs.

Guarantees Against Inconvertibility - Transfers to Belgium for purposes of capital investment in a corporation ("societe anonymenaamloze vennootschap") or advances in the nature of medium or long-term loans and for the opening and operation of a branch, which contribute to the country's economic development, can be made through the official market provided that a prior authorization from the Exchange Control Board is obtained.

REPATRIATION OR REMITTANCE RESTRICTIONS:

All foreign investments including earnings can be freely repatriated.

Investors generally have to apply for an authorization from the Exchange Control Board because it is only with such an authorization that the repatriation may take place through the official market. If such an authorization is not obtained, investors may only make the transfer through the free market.

EMPLOYMENT RESTRICTIONS:

Work permits - Employees and workmen who are nationals of the European Economic Community (EEC) countries do not need special authorization to work in Belgium. However, nationals from non-EEC countries need a work permit. Work permits are granted by the Belgian Ministry of Labor on application by the employer. Before taking up residence in Belgium, directors of foreign nationality, except those who are nationals of EEC countries, must obtain a professional card (carte professionnelle -

beroepskaart). Managers of branches of foreign companies must obtain work permits unless they are nationals of an EEC country.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Belgium is a member of the European Economic Community and subject to its commercial and customs regulations.

Most goods can be imported and exported from Belgium without limitation and in only a limited number of cases are licenses required.

Rules of origin common to all the EEC states are implemented when restrictions apply to certain products.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

Both tax and non-tax incentives are available to encourage investment in general throughout the country and in special development areas and industries.

The Belgian tax administration grants special tax concessions to non-Belgian executives and employees who "temporarily" exercise an activity in Belgium. Those who are entitled to benefit from the special concessions are treated as nonresidents for tax purposes. They must declare their worldwide earned income and their income from real property located in Belgium. Foreign source investment income is not taxable in Belgium exept when

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collected through a Belgian financial institution, when it would be subject to a withholding tax of 20 percent. Belgian source investment income is also subject to a 20 percent withholding tax. The investment income of nonresidents is not subject to any Belgian taxation other than withholding tax.

It should also be noted that, for those who may benefit from these concessions, the special tax which may be due by individuals on certain capital gains is not applicable; and certain school fees and costs paid on their behalf need not be included in their taxable income.

Persons eligible - The special tax concessions may be granted to non-Belgian executives (including directors who effectively exercise managerial functions) and employees, who have been:

- Transferred to Belgium by a foreign enterprise to work temporarily either in one or several establishments of such an enterprise or in one or several companies which are controlled by the foreign enterprise;

- Transferred to Belgium by a foreign company belonging to an international group to work temporarily in one or several Belgian companies which form part of that group or with a Belgian office that controls or coordinates enterprises belonging to the same group;

- Recruited directly outside Belgium by a Belgian subsidiary of a foreign company or by a company which forms part of an international group, to work temporarily with the Belgian company itself or with a control or coordination office established in Belgium by the international group.

The concessions may also be extended to non-Belgian research workers directly recruited outside Belgium by Belgian or foreign scientific research centers and laboratories, to exercise their activity temporarily in Belgium.

To be able to benefit from the special tax concessions, the individuals concerned must exclusively exercise functions requiring highly qualified specialists or involving special knowledge and responsibility or managerial ability, or they must be involved exclusively in activities as research workers in a scientific research center or laboratory.

Although the persons referred to above are, in conformity with common law, residents of Belgium, they may nevertheless be considered as if they were nonresidents having a dwelling at their disposal in Belgium, and for this reason benefit from the special tax concessions when:

- Their spouse or children remain outside Belgium;
- They continue to have a dwelling outside Belgium; or
- They maintain the center of their economic interests outside Belgium,for instance, because of the ties they have with the foreign enterprise and the possibility that because of such ties or in carrying out their contractual obligations, they may have at any time to transfer to another country the seat of their activity in the service of the foreign establishment or enterprise.

The tax concessions are granted for a period of eight years commencing at the time the activity starts in Belgium. However, for practical reasons, when the activity does not start at the beginning of the year, the concessions may be granted for the full year during which the eight year limit expires. (For instance, if the activity started in Belgium on August 1, 1975, the eight year period will expire on December 31, 1983). Those who were already in Belgium on January 1, 1975, may continue to benefit from the concessions from the time they started their activities up to December 31, 1982, provided that the conditions to benefit from the concessions are fulfilled.

Foreign executives in a research center or control or coordination office who exercise activities so important that their further stay in Belgium is necessary may obtain an extension of the eight year period.

Junior employees who start their activities in Belgium from January 1, 1980 onwards are in principle no longer entitled to the special concessions. Those who started their activities in Belgium prior to January 1, 1975 and qualified for the tax concessions were entitled to benefit from them until December 31, 1979, whereas those who started their activities in the period from January 1, 1975 to December 31, 1979 and qualify for the tax concessions may benefit from them until the end of the year in which a five year period since their arrival in Belgium expires.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: BERMUDA

INTRODUCTION:

Bermuda discourages investment by foreign entities in "local" businesses, i.e. companies operating within the local commercial sphere, but actively encourages incorporation of companies by foreign entities which will operate offshore from a place within Bermuda. Because of Bermuda's size it is felt that Bermudian business would be prone to overseas control if left to natural devices of commercial activity. The local government therefore protects local business by imposing ownership restrictions. The government, however, encourages foreign participation in the international financial community by exempting from these restrictions companies which are incorporated in Bermuda but carry on their business outside Bermuda from a place within the island.

OWNERSHIP RESTRICTIONS:

"Local companies" must be at least 60 percent Bermudian owned. Special exemptions are given on an individual basis for companies operating within the hotel industry.

EXCHANGE CONTROLS:

Exchange controls are in effect for all local residents and any operations in foreign currency must be effected through the authorized banks. Exempted companies operate outside of these

controls but are specifially prohibited from dealing in Bermudian currency except where required to pay day-to-day local expenses.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Foreign investment in local companies must be registered with the Bermuda Monetary Authority to ensure repatriation rights and remittance of profits. All payments to a non-resident entity by a local company must be approved by the Bermuda Monetary Authority.

EMPLOYMENT RESTRICTIONS:

Work permits for foreign personnel hired on either a permanent or temporary basis are required. Preference is given to Bermudian nationals in all employment. Work permits are available for 6 months in the first instance and are renewable annually thereafter.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

The Bermuda Government will enter into an agreement with an "exempted company" whereby the company may be exempted from all taxes on income, capital gains etc., for a period ending in 2006.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: BRAZIL

INTRODUCTION:

Brazil does not actively encourage foreign entities to set up local manufacturing operations, except in very specific areas where the lack of know-how or necessary resources renders outside help essential.

On the other hand, the presence of foreign capital in the most varied sectors of the economy, particularly in the automobile and heavy machinery industries, has always been justly and impartially treated in line with policy and legislation regulating foreign investments. Occasionally, and only in isolated circumstances and those deemed to be of interest or essential to the retention of national sovereignty over certain sectors of economic activity, has foreign capital been prohibited from entering the country.

The Brazilian government is aware of its limited capacity to generate its own resources for stimulating the necessary economic development to meet the growing demand for employment. For this reason the government regards foreign aid as vital to achieve its economic and social goals.

Through legal mechanisms, particularly in the tax area, Brazil has been encouraging the reinvestment of profits earned in the country and discouraging repatriation of same.

These policies have been in effect for some years, but as the country achieves a higher level of industrialization, it is anticipated that a greater degree of industry nationalization will occur. Locally owned businesses are given priority in competition for government contracts.

OWNERSHIP RESTRICTIONS:

Foreign ownership of newpapers, television or radio stations, and operation of coastal shipping is prohibited.

Foreign ownership of Brazilian airlines is restricted.

Foreign ownership of financial institutions is restricted to minority participation.

Direct or indirect foreign ownership of rural real estate is strictly regulated.

Technology agreements are subject to government appraisal of the necessity of service to be rendered and local availability of technology involved.

Petroleum exploration and the postal service are government monopolies. However, foreign companies are allowed, under specific circumstances, to participate in petroleum exploration under risk contracts.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange and through registered brokers.

Prior Central Bank of Brazil approval is required for all foreign currency loans.

The standard fine for infringement of exchange controls is 100 percent of the amount of the transaction in question. Higher fines are also applicable.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the government to ensure repatriation rights.

Capital, loans, and technology agreements must be registered to ensure remittance rights.

Any new investment or capital increase must be reported to the Central Bank within 30 days.

Profits may only be remitted on capital brought into Brazil or on reinvestments of profits derived from such capital.

Supplementary taxes are imposed on remittance of profits in excess of certain limits.

Capital repatriation in excess of the amount registered in foreign currency at the Central Bank (i.e., capital gains), is subject to withholding tax and must receive special approval.

Royalties may not be remitted by a Brazilian subsidiary to a foreign parent.

Remittances of service fees are subject to government verification that such services have been effectively rendered.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or a temporary basis.

Two-thirds of employees of all commercial, industrial or other enterprises must be Brazilian nationals in terms of both number and total remuneration. Exception may be made for skilled laborers and technicians.

In the event of layoffs, Brazilian nationals whose duties are identical to those of foreigners, must be given preferential treatment as regards retention.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Prior government authorization is required for the operation of industries with foreign capital investment.

In such cases, authorization is conditional upon the utilization of a minimum percentage of domestic raw materials or intermediary products.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: CANADA

INTRODUCTION:

Traditionally, foreign investment has been welcomed in Canada. The development of Canadian natural resources has required substantial injections of foreign capital, both debt and equity, and foreign investors have played a very significant role in the growth of the Canadian economy since the Second World War. However, as the Canadian economy matures there has been an increasing tendency for the National and Provincial governments to impose some restrictions on new foreign investment, particularly in certain sensitive sectors of the economy. In spite of this, there are still relatively few restrictions in Canada if the country is compared to other industrial countries.

OWNERSHIP RESTRICTIONS:

- Foreign ownership of radio and television broadcasting stations and networks is restricted to 20 percent.
- Foreign ownership of financial intermediaries such as Canadian banks, life insurance companies, trust companies, etc., is generally limited to 25 percent of each class of the capital stock with no single investor being permitted to own more than 10 percent. However, it may be possible to circumvent certain of the restrictions by incorporating in certain provinces.
- Foreign controlled banks, in total, are restricted to holding 8 percent of total Canadian banking assets.
- Oil and gas and mining rights to land in the far north can only be obtained by companies which are at least 50 percent Canadian owned or which are listed on a Canadian stock exchange.

- Certain of the provinces impose restrictions on foreign investment in certain industries, such as provincial financial intermediaries, and on foreign ownership of agricultural land.

EXCHANGE CONTROLS:

Canada currently has no system of exhange controls.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no restrictions on the repatriation of capital or remittances of dividends, profits, interest, royalties, management fees, loan repayments or settlement of trade debts.

However, payments of an income nature may be subject to withholding tax in Canada when paid to a non-resident.

EMPLOYMENT RESTRICTIONS:

Visas or work permits are required for foreign personnel hired on either a permanent or temporary basis. To obtain permits, the employer must certify that no suitable Canadian candidate can be found to fill the particular position. Permits are issued for up to one year with a possible one-year extension. For longer stays, the candidate must apply for landed immigrant status before coming to Canada.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no local material content requirements. There are government imposed tariffs and duties on some goods imported into Canada. However, in some instances there are no or lower duties applied to raw materials or partly manufactured goods, as opposed to finished goods.

OTHER RESTRICTIONS:

The Foreign Investment Review Act (FIRA) provides a mechanism to screen certain foreign direct investment proposals to determine whether or not the investment is likely to be of significant benefit to Canada. FIRA applies to only two forms of foreign investment:

- The acquisition of control of a Canadian business enterprise by foreign persons or groups containing foreign members, through the acquisition of shares or of the property used in carrying on the business; and

- The establishment of a new business in Canada either by foreign persons who do not already have an existing business in Canada, or by foreign persons who have an existing business in Canada, if the new business or expansion is unrelated to the existing business.

FIRA is concerned with the acquisition of control of Canadian business enterprises, not with the acquisition of shares or assets where that acquisition does not constitute control. Thus, portfolio investments are generally not subject to review.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

The Federal and Provincial governments offer a wide range of research and development and other industrial incentive programs

using such methods as grants, loans, cost sharing, technical assistance and income tax incentives. Most of these incentives are available to any corporation formed in Canada, regardless of whether it is Canadian or foreign controlled.

The National Energy Program provides for incentives to encourage exploration for oil and gas in Canada. The amount of the grant depends on both the location of the land and on the percentage of Canadian ownership in the company carrying out the exploration. For example, the highest grants are available for exploration in the Far North, where a 75 percent or greater Canadian owned company would receive a grant equal to 80 percent of the qualified expenditures, a 65 percent to 79 percent Canadian owned company would receive 65 percent, a 50 percent to 65 percent Canadian owned company would receive 50 percent, and a less than 50 percent Canadian owned company would receive only 25 percent.

NON-TAX INVESTMENT RESTRICTIONS

CAYMAN ISLANDS

INTRODUCTION:

Generally, the Government is receptive to ideas creating employment and the expansion of the economic base of the islands, and foreign investment is welcomed except in areas presently served by locally-owned enterprises.

In the absence of trade unions of significant size, there is usually little labor opposition to new foreign investment, particularly if it is likely to result in employment opportunities for local labor.

OWNERSHIP RESTRICTIONS:

Generally, in order to conduct business in the Cayman Islands a company must be not less than 60 percent beneficially-owned by Caymanians, or must apply to the Caymanian Protection Board for a license under the Local Companies (Control) Law of 1971. In considering the application, the Board will take into account the current economic situation, the due protection of persons already engaged in the trade, the reputation of the investors, the desirability of retaining Caymanian control, and efforts made to obtain Caymanian participation. Licenses are granted for periods of not less than 12 years. If an application is refused, appeal may be made to the Executive Council.

No industries are closed to private enterprise other than the usual government activities. In the fields of education and medicine there are private as well as Government-provided facilities.

EXCHANGE CONTROLS:

None since March 17, 1980.

REPATRIATION OR REMITTANCE RESTRICTIONS:

None

EMPLOYMENT RESTRICTIONS:

Foreign personnel require work permits (gainful occupation licenses) in order to enter the Cayman Islands for the purpose of employment.

Permits are normally granted where it can be shown that no Caymanian is available to fill the position.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

With the exception of goods prohibited by law, such as base or counterfeit coins or gambling equipment; and items which require import permits, such as firearms, vans, prefabricated buildings (other than storehouses and aircraft hangars), and plants, there are no import restrictions.

Duty is charged generally at the rate of 20 percent, although certain items are duty free, including agricultural machinery and supplies, certain basic foodstuffs and luxury items such as watches, jewelry, cameras, fine china and glassware. Duty is charged on motor vehicles at 27.5 percent, and on gasoline and diesel oil at eight cents per gallon.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

There are no taxes on income, profits, sales, capital, capital gains or real estate in the Cayman Islands.

Industries catering to the export market with an investment exceeding $50,000 and employing at least four Caymanians for a minimum period of 5 years may be granted full waiver of customs import duty on building material and equipment, machinery, and tools of trade. Material for use in the manufacturing process may also be granted waiver of import duty.

Industries providing for the local market with an investment exceeding $25,000 and employing at least 4 Caymanians for a minimum period of 3 years may be granted waiver of customs import duty on building material and equipment, machinery and tools of trade. Material for use in the manufacturing process may also be granted waiver of import duty.

A company which does not require a license under the Local Companies (Control) Law to operate, which invests a sum of at least $10,000 in a new industry and which employs at least 2 Caymanians for a minimum period of 3 years, will be examined individually by the Executive Council for the purpose of considering waiver of customs import duty under Section 49 of the Customs Law.

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The Government will not provide land for any form of private sector development, but consideration may be given in very special circumstances.

Other concessions are also granted. The Tax Concessions Law grants tax relief for a given period.

The Government recognizes the contribution which the tourist industry makes to the Cayman economy and, in order to attract foreign capital for hotel investment in the islands, has enacted legislation under the Hotels Aid Law giving import duty concessions to the hotel industry.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: CHILE

INTRODUCTION:

Chile's overall policy is to encourage foreign investment by providing suitable guarantees for repatriation of capital and profits and by a progressive elimination of restrictions of all types. This policy is in line with the free market concept underlying Chile's economic policy over the past 8 years. To this effect, foreign investment laws have been issued such as Decree Law 600 (The Foreign Investment Statute), which guarantee repatriation of capital and profits with no quantitative limit and provide for nondiscrimination between Chilean and foreign investors. In general, business opportunities are similar for national and foreign investors.

OWNERSHIP RESTRICTIONS:

Foreign ownership of real estate adjacent to national boundaries requires Government approval.

Foreign (and national) ownership of mining property is restricted to a concession with certain mine ownership characteristics.

Operation of coastal shipping is normally limited to national companies.

EXCHANGE CONTROLS:

In general, operations in foreign currency may be effected only through banks or other entities authorized to deal in exchange. However, foreign or national natural or juridical persons can freely trade in foreign currency on an occasional basis, provided there are no special rules governing the pertinent exchange operations.

Normally, export proceeds must be returned and liquidated with authorized entities within certain time limits. However, exporters can repurchase foreign currency at the time of liquidation of up to 10 percent of the value of the export and hold up to US $100,000 in a current account to cover expenses abroad.

The Central Bank must approve all foreign credits.

Fines for serious infringements vary from 30 to 200 percent of the operation, and fines for less serious infringements range from one to 200 percent of the operation.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investment must be registered with the Government to ensure repatriation rights.

Capital, loans and technology, royalty and service agreements must be registered to ensure remittance rights.

Repatriation of capital in excess of the amount initially registered or in excess of authorized reinvestment must receive special approval.

Equity investment must remain in the country at least 3 years before repatriation. Profits can be remitted periodically.

Credits must remain in the country at least 24 months on average, and interest remitted every 6 months.

Credits are subject to deposits with the Central Bank depending on the amortization period. If it is under 48 months, the deposit requirement is 15 percent. If it is 48 months or over, but under 66 months, the deposit requirement is 10%. No deposit requirements exist if the average maturity term is equal to or higher than 66 months.

Remittance of profits, interest, royalty and service agreements are subject to normal taxes. Technical assistance and royalties qualified by the President of the Republic as unnecessary may be subject to tax restraints.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired either on a permanent or temporary basis. Eighty-five percent of the employees of all commercial, industrial or other enterprises employing more than 25 must be nationals of Chile. Exceptions may be made for skilled laborers and techicians who cannot be replaced by Chilean nationals.

Foreigners married to Chileans or who have Chilean children and those resident in Chile for more than 5 years are considered Chilean nationals for these purposes.

LOCAL MATERIAL CONTENT REQUIREMENTS:

The only local content requirements are for vehicles assembled or manufactured in Chile. These are as follows: Cars and vans with engines over 850cc with or without four wheel drive except jeeps, 30 percent. Transport vehicles over 880cc and 5.000 kilos payload, 15 percent.

OTHER RESTRICTIONS:

Limitations on access to local finance may be imposed on foreign investors subject to Decree Law 600. In practice, this provision has not been applied.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Under Decree Law 600 investors may obtain a fixed 49.5 percent income tax rate for 10 years with a one time option to change to normal tax rates and an agreement not to change the customs and tax treatment applicable to imports of goods included as capital investments and which were not produced in Chile until the investment is completed.

Foreign (and national) investors may apply accelerated depreciation to new assets acquired in Chile or new or used imported assets by reducing normal useful life to one third, with a one time option to change normal depreciation rates.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: CHINA

INTRODUCTION:

China encourages the transfer of foreign technology and equipment and cooperation with foreign investors through joint ventures and compensation trade and processing arrangements. The development of existing exports to finance future imports is encouraged, and, at the same time, all joint ventures and compensation, trade and cooperation arrangements will only be approved if the products are export oriented and if such ventures are self-financing and do not draw on China's limited foreign exchange reserves. The extent of foreign ownership is limited and is only permitted in the special economic zones covering Guangdong (Canton) and Fujian provinces. Strict exchange and repatriation contols are imposed to limit the outflow of capital.

OWNERSHIP RESTRICTIONS:

The Chinese authorities, as a general policy, do not encourage foreign ownership. Foreign ownership of land is prohibited by statute.

EXCHANGE CONTROLS:

Operations in foreign currency can only be effected through the Bank of China, the only bank authorized to deal in foreign exchange. Renminbi (local currency) is a non-convertible currency. The taking out of China of renminbi either in person or by post is prohibited.

Remittance can only be made from foreign currency deposit accounts in the Bank of China.

The circulation, usage and mortgage of foreign currency in China are prohibited.

Penalties for violation of exchange control regulations are fines and/or confiscation or imprisonment.

REPATRIATION OR REMITTANCE RESTRICTIONS:

All foreign exchange receipts of foreign enterprises must be deposited in the Bank of China and all foreign exchange disbursements must be paid from their deposit accounts.

Foreign enterprises must apply to the Bank of China for remitting net profits after tax as well as other legitimate earnings by debiting their foreign exchange deposit accounts.

Repatriation of capital in excess of the amount registered in foreign currency will be subject to special approval.

Remittance of dividends, rent, interest and royalties will be subject to tax restraints.

All foreign enterprises must register with the State General Administration for Industry and Commerce.

EMPLOYMENT RESTRICTIONS:

Entry visas are required for foreign personnel hired on either a permanent or temporary basis. A visa valid for up to 6 months will be granted for each application and can be renewed periodically.

The engagement of local personnel can only be arranged by government-owned enterprises called Commercial Services Corporations.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Foreign enterprises must register with the General Administration for Industry and Commerce before they are allowed to maintain office premises and to conduct business activities. Resident permits will be granted to registered employees only and are not transferable from city to city.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Joint ventures that are established to operate for at least ten years may be granted, upon approval by the Ministry of Finance, an exemption from income tax in the first profit-making year and a reduction of income tax in the second and third profit-making years of 15-30 percent.

Joint ventures in remote, economically underdeveloped outlying areas may, upon approval by the Ministry of Finance, be allowed a tax rebate of 15-30 percent for a period of 10 years.

A refund of 40 percent of the joint venture income tax paid is available to participants who reinvest a share of their profit for a period of not less than 5 years.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: COLOMBIA

INTRODUCTION:

Foreign investment in Colombia is governed by the rules of the Andean Pact, which imposes certain restrictions on foreign investment. Colombia has strictly applied the rules of the Andean Pact although there is a recent trend to liberalize their application, particularly for the petroleum and mining industries.

OWNERSHIP RESTRICTIONS:

Foreign ownership of finanial institutions is restricted to minority participation.

No new foreign investment is permitted in insurance, banking, financial institutions, public services, internal transport, publicity, and communications (radio, television, newspapers).

New foreign investment in the manufacturing sector is limited to a maximum participation of 85 percent, with the condition that this participation be reduced to no more than 49 percent over a period of 15 years.

All new foreign investment, technical assistance agreements and royalty contracts must have prior approval of the Colombian government.

Foreign contractors bidding on government contracts must have at least 20 percent national participation.

Exploration for petroleum must be made in partnership with the government oil company.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through official channels.

Prior approval of the Central Bank of Colombia is required for all foreign currency loans.

The normal fine for infringement of exchange controls is 100 percent of the related transaction. Higher penalties may also be applied.

REPATRIATION OF REMITTANCE RESTRICTIONS:

Investments must be registered with the government to ensure repatriation rights.

Capital, loans and technology agreements must be registered to ensure remittance rights.

Remittance of profits is limited annually to 20 percent of the registered foreign investment.

Remittance of dividends is subject to a withholding tax of 20 percent if certain conditions can be met; if not, the rate is 40 percent. Remittance of branch profits is subject to a 20 percent remittance tax.

Royalties may not be remitted by a Colombian subsidiary to a foreign parent or affiliate thereof.

Repatriation of capital in excess of the amount registered in foreign currency with the Central Bank is subject to withholding and remittance taxes.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

In enterprises with more than 10 employees, 90 percent of the labor force and 80 percent of other employees must be Colombian nationals. Exceptions are made for skilled technical help.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Except in the automotive assembly industry, there are no local material content requirements.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: COSTA RICA

INTRODUCTION:

Costa Rica actively encourages foreign entities to establish local operations, primarily in export-oriented industrial and agro-industrial activities. The government has established a very active export promotion center to faciliate the setting up of these operations. Although the government tries to encourage the reinvestment of profits in Costa Rica through fiscal incentives and withholding taxes on remittances abroad, there are few repatriation controls to limit the outflows of capital. The government nationalized the major public service industries (i.e. insurance, banking, transportation, public utilities, petroleum refining and distribution, etc.) several years ago, and it is not anticipated that further nationalization of major industries will occur. There is no apparent priority given to locally owned businesses in competition for government contracts. With respect to companies organized and operating in the Central American Common Market, exchange and remittance restrictions are less stringent.

OWNERSHIP RESTRICTIONS:

Foreign ownership of the communications media is restricted to minority participation.

Foreign ownership of banks is restricted to those which engage in limited banking operations.

Private ownership in nationalized industries is prohibited.

EXCHANGE CONTROLS:

Licenses are required for all imports goods. However, licenses will only be granted for imports from Central America and Panama and imports of essential items from other countries. Foreign exchange at bank selling rates may be available for imports of raw materials and other essential items but may have to be obtained at free market street rates for other items. Licenses are required for all exports of goods. Proceeds from all export sales must be sold to the Central Bank at current bank buying rates within a specified period of time. The normal fine for infringement of exchange control is 25 percent to 50 percent of the amount of the related transaction.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments do not need to be registered with the government to ensure repatriation rights. However, foreign exchange for remittance abroad must generally be obtained at free market street rates, since the Central Bank suspended registration of foreign capital and loans in December 1978 for purposes of repatriation at offical exchange rates.

Remittance of dividends and branch profits is subject to a 15 percent withholding tax.

There is no restriction on the remittance of royalties and service fees as long as they are reasonable and the corresponding taxes are withheld.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits in the form of residence permits are required for foreign personnel hired on either a permanent or temporary basis.

Ninety percent of total employees must be Costa Rican nationals and 85 percent of total payroll must be paid to them. These limitations do not apply to managers, directors, administrators, superintendents and general office heads, provided that there are no more than two each.

In the event of layoffs, nationals of Costa Rica are not given preferential treatment as regards retention.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: CYPRUS

INTRODUCTION:

Cyprus allows foreign entities to participate in local manufacturing operations and tourism provided the investment is in the interest of its economy and does not lead to unfair or undesirable competition with existing local enterprises. This policy is part of an overall effort to accelerate the development of Cyprus through the inflow of foreign capital and by acquiring superior know-how. There is no specific policy regarding foreign participation. Each case is considered on its merits. However, as the country achieves a higher level of development, a lower degree of foreign participation should be anticipated.

OWNERSHIP RESTRICTIONS:

Direct or indirect foreign ownership of land is strictly regulated.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange.

Prior approval of the Central Bank of Cyprus is required for all foreign currency loans.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the Central Bank of Cyprus to ensure repatriation rights.

Capital, loans and technology agreements must be registered to ensure remittance rights.

Any new investment or capital increase must be reported to the Central Bank of Cyprus.

Profits may only be remitted on capital brought into Cyprus or on reinvestments of profits derived from such capital.

Repatriation of capital registered with the Central Bank of Cyprus plus appreciation thereon is remittable abroad upon application to the Central Bank of Cyprus.

Remittance of dividends and branch profits on registered foreign investment is subject to exchange control permission.

Remittance of service fees is subject to government verification that services have been effectively rendered.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

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OTHER RESTRICTIONS:

Companies with foreign participation exceeding 20 percent are required to obtain financing from external sources pro-rata to the foreign participation.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: DENMARK

INTRODUCTION:

Denmark does not particularly encourage foreign entities to set up local operations.

In general, however, the conditions for investing in Denmark are liberal. Limitations may exist when the country in which the potential investor is resident does not offer Danish citizens equal possibilities to invest there.

The regulations relating to portfolio investments are not included in this memorandum.

OWNERSHIP RESTRICTIONS:

Investments by foreigners in Danish apartment buildings and other living accommodations and in farms and farmland are restricted. Special conditions exist for regulated industries such as banks, insurance companies, etc.

EXCHANGE CONTROLS:

Foreign direct inward investments may be made without permission up to DKr 1 million per annum. In those cases where permission is required it is normally granted with few exceptions.

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Foreign loans to finance purchase of fixed assets up to DKr 20 millions per calendar year may be taken up without Danish National Bank permission.

Loans in excess of DKr 0.2 million per calendar year from associated companies to provide working capital require Danish National Bank permission. Such loans may be restricted to four times the equity of the enterprise.

Operations in foreign currency may be effected only through banks and brokers authorized to deal in foreign exchange.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments requiring permission must be reported to the Ministry of Industry.

Other investments must be reported to the Danish National Bank.

Loans obtained to finance fixed assets cannot be repaid in less than five years, and the installments in any year cannot exceed 20 percent of the original loan face value.

Loans from associated companies to provide working capital cannot be repaid in less than five years.

Dividends must be paid within 30 days after being declared.

Profits of branches and partnerships must be remitted without undue delay, or they are added to the equity of the entity. When profits have been added to the equity a maximum of 20 percent of the equity can be remitted each year.

Foreign citizen residents must remit to Denmark during the first seven years in Denmark cash assets in excess of DKr 200,000. After that period all cash assets must be remitted to Denmark.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are not required for EEC citizens but residence permits must be obtained.

Work and residence permits are required for other nationals. Working permits for these foreigners can only be obtained when there are no skilled Danish workers available and then only for a period not exceeding the time needed to educate Danish workers for the specific type of work.

Entry visas are needed for foreigners from certain countries.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

There are basically no incentives specifically offered to attract foreign investment and the existing incentives granted to Danish citizens are also available to foreign investors.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: DOMINICAN REPUBLIC

INTRODUCTION:

The attitude of the Dominican Government towards foreign investment is to accept all foreign investment in areas that are not adequately covered and which contribute to the economic development of the country, providing employment and generating foreign exchange.

In order to stimulate foreign investment in industrial projects, mainly those using intensive labor, the Dominican Government has encouraged the creation of industrial free zones, where all taxes, including income tax, are exempted to foreign investors and where they can freely import raw materials and export finished goods. Also, the Dominican Government is very interested in promoting tourist development as an additional source of foreign exchange. Therefore, the Government is developing an extensive program to endow areas with tourist potential with the necessary infrastructure facilities.

OWNERSHIP RESTRICTIONS:

In accordance with foreign investment law:

Corporate capital composition should be structured as follows:

- Over 70 percent owned or controlled by local investors - National (local) enterprise.

- o 51 percent and over (but less than 70 percent) owned or controlled by local investors - mixed enterprise.
- o 51 percent and over owned or controlled by foreign ownerhip - foreign enterprise.

The following areas are banned from registration of foreign capital at the Central Bank:

Public Services, such as potable water and aqueducts, electrical energy, mail, telecommunications, telephones, the exploitation of radioactive materials, minerals, hydrocarbons and real estate except for tourist projects.

The following are considered areas of activity for national enterprises:

The production of materials and equipment directly linked to national defense and security, news media and publishing, internal transport, except for container vans moving import-export cargoes, internal air transport, costal transport and international shipping and forestry.

The following are considered areas of activity for national and mixed enterprises:

Agricultural, poultry and cattle, fishing, commercial and investment banks and other financial institutions and insurance.

Technical assistnce agreements between a local company and a foreign company abroad may be registered at the Central Bank under certain conditions. However, registration of technical assistance agreements for foreign enterprises is not permitted.

EXCHANGE CONTROLS:

The Monetary Authorities have the power to regulate all foreign exchange transactions. All individual enterprises are required by law to make available to the banking system whatever foreign exchange is received in exchange for pesos through any kind of transaction.

Foreign exchange remittances of all types are dependent upon the availability of foreign exchange at the Central Bank.

Borrowing from abroad can only be made with the prior approval of the Monetary Authorities.

The importation of a considerable number of commodities is restricted or prohibited. Approval of the Central Bank is required for the payments of all imports for which foreign exchange is requested.

Approval by the Central Bank for imports is not required if the importer does not request foreign exchange from the banking system to pay for them. Imports may be paid for with dollars obtained in the parallel market, on which at times during 1981 the premiums have exceeded 25 percent.

Very few importations are being financed with foreign exchange from the banking system.

Recently the Dominican Government issued a decree banning importation of vehicles with foreign exchange from the banking system or from the parallel market for one year.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Foreign investment must be registered with the Central Bank to ensure repatriation rights.

Remittances of dividends of foreign subsidiaries, profit of branches, interest on loans from abroad and capital repatriation are allowed, provided that the related inward capital has been registered at the Central Bank.

Technology agreements must be registered to ensure remittance rights.

Foreign investors with registered capital at the Central Bank, who either sell or transfer their holdings to another foreign investor, must report such sale or transfer to the Central Bank no later than 30 days thereafter.

Capital gains on stockholding investments previously registered at the Central Bank are limited to 2 percent per year on the registered amount up to a total of 20 percent from registration date.

Remittable profits are limited to 18 percent of registered capital. Approval must be requested within two years from the fiscal year end. Remittable profits are subject to a withholding tax of 18.54 percent.

Laws on foreign investment essentially apply to those investments registered or about-to-be registered as such at the Central Bank. Foreign investors may organize local subsidiaries or branches, except as to areas specifically prohibited by the law. Such investments, however, will not enjoy capital repatriation or

profit remittances at par with the Dominican peso, or any industrial incentives.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

The proportion of Dominican nationals in all commercial, industrial or other enterprises must be at least 70 percent. Similarly, the 70 percent test is applicable to total salaries. However, non-Dominican citizens and their earnings can be excluded from the respective totals under certain conditions, e.g., if they are part of management or have specialized technological skills not possessed by unemployed Dominican citizens.

In the event of layoffs and reduction in the workforce by production problems, material shortages or economic reasons, Dominican Republic nationals must be given preferential treatment as regards to retention.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

The Dominican Government cannot endorse or guarantee directly or through its official or semi-official lending institutions, foreign credit operations to foreign enterprises.

Foreign enterprises cannot obtain internal credit for more than one year, without the authorization of the Central Bank.

Foreign enterprises are excluded from reinvestment tax exemptions granted by law No.299 on Industrial Incentives and Law No.532 on Agriculture and Livestock Promotion.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Industries established in the free zones are granted complete exemption for 20 years from income taxes and custom duties and related taxes on building materials, equipment, raw materials, semi-finished materials, fuels and lubricants (but no gasoline) transportation equipment, etc., imported for use in connection with industrial activities within the zone.

Companies operating in free zones are not subject to the currency controls in effect in the Dominican Republic and need not convert the proceeds of their export sales into local currency, except for local currency required to cover costs and expenses of operations within the zone. Incentives granted under the Tourism Law are: 100 percent income tax exemption for a period of 10 years, and 100 percent exemption from import duties and taxes on material not available locally which are necessary for the construction and furnishing of facilities .

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: ECUADOR

INTRODUCTION:

Ecuador recognizes the need for foreign investment and is likely to avoid actions that would discourage it. Foreign investments made within the framework of the regulations of the Foreign Investment Code (Decision 24) of the Andean Pact are welcomed, particularly if made in those industrial projects that Ecuador considers of high priority for the development of the economy. Foreign capital and technology restrictions issued by Ecuador, as well as exchange and repatriation controls, are based on the Foreign Investment Code, which attempts to induce the industrialization and integration of the Andean Pact countries.

OWNERSHIP RESTRICTIONS:

All investments of foreign capital must be registered with the Central Bank of Ecuador once the necessary authorization from the Ministry of Industries, Commerce and Integration (MICEI) has been obtained. The MICEI approves, on a case-by-case basis, the percentage of foreign ownership.

Foreign ownership of public service companies is prohibited, and new direct foreign investments are allowed only in existing foreign companies which need the new investment in order to operate in an efficient manner.

New foreign investment in commercial banks, insurance and finance companies is restricted to a minority participation. For existing foreign capital, the reinvestment of profits and the contribution of additional capital require authorization from the MICEI and are restricted to the percentage held in order not to increase foreign ownership. Investments of these companies in other local companies also require authorization from the MICEI. However, the establishment of branches of foreign banks may be authorized, provided a branch of an Ecuadorian Bank abroad is established simultaneously.

New foreign investment in construction companies is restricted to a minority participation (no more than 20 percent), except when the investment is made in companies engaged in promoting and financing urban development projects, buildings and housing or in selling, renting or managing real estate.

New foreign investment in companies engaged in internal distribution of foreign or national products (including investment for the importation of such foreign products) is restricted to a minority participation (no more than 20 percent), unless the activity refers to internal distribution of products and a transformation contract to reduce foreign capital to a minority participation is signed; the company involved plans to use distribution systems and procedures which integrate national industry or production; or the company involved is located in cities other than Quito and Guayaquil. New contributions of capital and reinvestments may be made, provided the percentage of foreign ownership does not increase.

New foreign investments for the formation of companies engaged in internal transportation may be authorized, provided such companies sign a transformation contract whereby foreign ownership constitutes a minority.

The establishment of branches of foreign companies is not allowed unless their stay in the country is to be temporary, and unless legal requirements demand it.

All contracts dealing with transfer (importation) of technology (trademarks, patents, licenses, technical services, management services, etc.) must be authorized in advance by the Technology Committee of the MICEI and registered with the Central Bank and with the Directory of Patents and Trademarks, when applicable.

EXCHANGE CONTROLS:

Prior approval of, and registration with, the Central Bank of Ecuador is required for all foreign currency loans.

As Ecuador maintains an official and a free foreign exchange market, which function simultaneously, a choice exists in the case of private foreign investments or foreign loans as to whether the funds will be brought into the country on the free market or through the Central Bank at the official rate.

The market selected for entry of funds is used for repatriation of capital and payment of dividends, loan principal and interest. The rate of exchange applicable is that in effect at the time of remittance, in either the official or free exchange market.

The Central Bank provides the necessary funds for the repatriation of investment and profits and for the servicing of foreign debts, when the investment or debt has been registered and the related foreign exchange has been sold to it.

Interest rates on foreign loans are determined by the authorities and may exceed the local conventional rate (12 - 15 percent, at

present) as long as the effective rate does not exceed by 2 percent the London Interbank Offering Rate (LIBOR) or the U. S. prime rate.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Ecuador guarantees repatriation of capital upon sale of stock or liquidation of a company, provided taxes due have been paid. Repatriation of loan principal and interest, according to the terms of the approved agreement, is also guaranteed.

Reinvestments, when authorized and registered, are considered repatriable capital and, in effect, form part of the foreign investment with right to be remitted abroad.

Annual remittances of profits cannot exceed 20 percent of capital registered as foreign investment at the Central Bank of Ecuador. In practice, this 20 percent of capital is considered to be net of income taxes paid.

Royalty rates and the duration of contracts are normally regulated when the related contracts are submitted for approval to the Technology Committee of the MICEI. Such regulation takes into account the nature of the technology. Royalty payments are normally made through the free exchange market, as no specific regulations have been issued authorizing the use of the official exchange market.

Royalty payments made to head offices or to affiliated companies by companies where foreign ownership has a majority participation are normally not authorized. If such payments are made, the related charges may not be allowed as deductions for tax purposes.

The remittance of branch profits, like dividends on capital invested, may not exceed 20 percent of related registered (assigned) capital.

EMPLOYMENT RESTRICTIONS:

Foreign personnel require a work visa or an immigrant visa in order to be allowed to work in Ecuador.

Companies with more than five employees are required to employ at least 80 percent of their work force from among Ecuadorians. Employers may request permission from the Ministry of Labor to employ foreigners in excess of 20 percent of the total work force if the positions involved require technical skill and cannot be filled by Ecuadorians.

Employment contracts of foreign personnel must provide for training of at least 3 Ecuadorians.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Development laws generally establish that companies classified under such laws must cover their needs of raw materials, machinery, equipment and parts in the local market before they can import them duty free.

Companies classified under the Automotive Development Law are subject to some limitations regarding certain basic component parts which must be obtained from local manufacturers or within the Andean Region.

OTHER RESTRICTIONS:

Generally foreign investors may not be authorized to buy stock from national investors. Transfers of stock between foreign investors require authorization from the MICEI and registration at the Central Bank of Ecuador.

The favorable tariff treatment and other provisions of the Cartagena Agreement apply only to enterprises where foreign ownership has (or will have) a minority participation.

Enterprises authorized to start with a majority of foreign ownership are required to sell to national investors (over a specified period, which should not exceed twenty years) such percentages of their shares as may be necessary to change foreign ownership to a minority position.

Locally organized companies where foreign ownership has a majority participation must obtain authorization from the MICEI to invest in another local company. Excepted from this requirement are capital increases, provided such investments have not been prohibited in the economic sector where the company receiving the investment operates, and the increase does not change the percentage participation of the investing company in the stock of the other enterprise.

Locally organized companies where foreign ownership has a majority participation may not participate in the formation of new banks, finance and insurance companies, but may participate in the capitalization of reserve and/or retained earnings, provided their percentage of capital ownership does not increase.

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In addition to authorization from the MICEI, existing insurance companies where foreign ownership has a majority participation need authorization of the Superintendency of Banks and Insurance Companies to invest in other insurance and finance companies, banks and any other corporations in accordance with the specific law which regulates the activities of insurance companies.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Foreign investors enjoy the same benefits and investment incentives granted to national investors, as it is the company in which the investment is made that receives the benefits. All development laws provide for deductions for income tax purposes of authorized amounts spent on plant expansion or improvements. Export incentives in the form of negotiable tax credit certificates, representing percentages of the aggregate value of certain exports, are granted to companies making such exports.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: EGYPT

INTRODUCTION:

Egypt actively encourages foreign entities to set up local projects in the following fields:

- Industry, mining, energy, tourism, transportation and other related fields;
- Animal production, water resources and reclamation and cultivation of barren and desert land;
- Housing and urban development;
- Banks and investment companies;
- Construction activities; and
- Technical consultancy firms.

This policy is part of an overall effort to develop the economy of Egypt and to provide employment for its nationals. Egypt is also attempting to encourage reinvestment of profits in the country through the granting of certain tax exemptions.

OWNERSHIP RESTRICTIONS:

Foreign ownership of newspapers and television and radio stations is prohibited.

A certain percentage of Egyptian participation is required which varies from 25 percent to 51 percent.

Reinsurance companies and banks operate in foreign currencies. Free zone companies may be fully owned by foreigners.

Technical agreements are subject to governmental appraisal.

EXCHANGE CONTROLS:

Operations in foreign currency must be conducted only through authorized banks.

A yearly statement of transactions in foreign currency bank accounts must be submitted to the authorities.

The normal fine for infringement of exchange control regulations is confiscation of the amount involved, along with imprisonment.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Invested capital must be registered with the authorities to ensure repatriation rights.

Technology agreements must be approved by the authorities to ensure remittance rights.

Capital increases must be approved in the same manner as the original capital.

Profits may only be remitted after being approved by the authorities and from the available foreign currency funds of the company.

Repatriation of capital in excess of the amount registered with the authorities (i.e. capital gains) is subject to taxes in Egypt.

Remittance of dividends and branch profits is subject to taxes after the tax holiday period expires.

Royalty remittances are subject to withholding taxes, and approval of the authorities.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

Seventy-five percent of employees must be nationals in terms of number, and their remuneration should not fall below 65 percent of total salaries and remunerations.

In certain entities employees' participation on the board of directors along with profit sharing are mandatory.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Egypt provides a 5-8 years tax holiday to companies established under the Investment Law. In addition, custom duties exemptions on imported fixed assets may be granted.

Companies established under the Investment Law may also be exempt from:

- Required employee participation on board of directors;
- Required employee participation in profits;
- Certain provisions of the exchange control regulations;
- General Income Taxation of expatriates; and
- Price fixing.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: FIJI

INTRODUCTION:

It is the intention of the Fiji Government to encourage and help local industries and businesses whenever possible. However, it does recognize that foreign capital, technology and management can make enormous contributions to Fiji's economic and social development. The Government intends to keep certain controls over foreign investment which affect the security, necessities of life and living conditions of Fiji nationals so as to maintain political and economic sovereignty. The purpose is not to discourage foreign investment, but to rationalize the development of different parts of the economy and to ensure that unnecessary competition from abroad does not discourage local investment. While welcoming overseas capital, the Government is encouraging Fiji citizens to expand locally-owned enterprises and establish new ones.

OWNERSHIP RESTRICTIONS:

There are no restrictions on the ownership of any particular industry, provided it meets the basic requirement that a foreign investment in the concerned field is desirable. In most cases, however, foreign investment with an element of local participation is encouraged.

EXCHANGE CONTROLS:

The Ministry of Finance controls all remittances both in and out of Fiji through the Central Monetary Authority (CMA).

Overseas investors require exchange control permission to make any investments in Fiji.

Issue or transfer of shares involving nonresidents require CMA approval before registration may be effected.

Fiji business operations controlled by nonresidents may borrow locally only such amount which bears to total loan funds employed in Fiji the same portion of locally held equity in the business to total equity. Normally, CMA requires that nonresident controlled businesses have a bearing of equity to total loan funds employment of one to three. Trading banks may lend up to F$20,000 to nonresidents in business for a period of up to three months without prior CMA approval.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Repatriation of capital and earnings (either dividend or interest) is generally approved after income tax clearance has been obtained from Inland Revenue Department.

Overseas loans require CMA approval before funds can be obtained. If this approval is not obtained, repayment of the loan and payment of interest on loan will be difficult.

EMPLOYMENT RESTRICTIONS:

Work permits are required for nonresidents to enter and work in Fiji. These will be issued provided the position in question cannot be adequately filled by a local person. Employers are required wherever possible to train local persons to fill positions occupied by nonresidents.

Permits to enter and reside will also be granted to investors in Fiji.

These permits are usually granted initially for a three-year period. They may be renewed (normally for no longer than a total of five or six years) if the continued presence of the holder is considered to be to Fiji's economic advantage or if the person concerned is shown to be indispensable to the employer.

Visitors' permits, valid for up to one month in the first instance, are issued on arrival for nonresidents investigating investment opportunities.

LOCAL MATERIAL CONTENT REQUIREMENTS:

While customs and import duty concessions are granted in respect to new enterprises, the investors are specifically required to purchase locally the equipment which is available in Fiji.

OTHER RESTRICTIONS:

Import of certain specific items requires prior approval from the concerned Ministry. The number of items in this category is limited.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

No subsidies and incentives are available only to foreign investors, but rather to all investors in a particular industry, or area. These include the hotel industry, mining industry, certain areas of primary production, new approved industries considered to be of importance for the economic development of Fiji, and exporting industries.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: FINLAND

INTRODUCTION:

Foreign investment in Finland has contributed significantly to the increase in the economic well-being of the country, and the government has long looked favorably on direct investment. From the Finnish standpoint, the most welcome investments are those which create lasting employment and can raise the technical level of the country's industry in accordance with the general objectives of Finland's industrial policy.

In principle, foreign enterprises locating in Finland are treated no differently from enterprises owned completely by Finnish nationals. This is true, for example, in the case of tax legislation and the economic assistance granted by the state to enterprises establishing in the development areas. On the other hand, no special privileges are offered to foreign investors.

OWNERSHIP RESTRICTIONS:

Foreign investments are generally not permitted in the forest and wood processing industry, or in mining. Foreign ownership in professional trading in real estate, trading in foreign currency and atomic energy production is not permitted. Legal provisions restrict a foreigner's right to engage in pharmacy, insurance, domestic commercial aviation and coastal shipping.

Foreign ownership in excess of 20 percent of the shares in financial institutions may be permitted by the Council of State only on special grounds after consulting with the Bank of Finland. At present there are no foreign-owned banks in Finland.

Real estate may not be owned or leased by a foreigner for a period longer than five years without permission from the Council of State. A Finnish company may not acquire real estate in Finland without the prior consent of the Council of State, unless its articles of association (by-laws) restrict to one-fifth the amount of the share capital that may be held by foreign citizens and corporations, (so-called alien's clause) or by Finnish companies whose by-laws do not contain such a restriction.

EXCHANGE CONTROLS:

In general, all foreign exchange transactions are subject to the control and supervision of the central bank (Bank of Finland). Within the limits prescribed in the foreign exchange regulations, authorized banks, primarily the commercial banks, can transmit most currency payments and certain capital transfers abroad without the special permission of the Bank of Finland.

Prior approval of the Bank of Finland is required for investment by foreigners or foreign corporations in shares of Finnish corporations, whether establishing a subsidiary in Finland or taking over an existing Finnish company.

Prior approval of the Bank of Finland is also required for all foreign loans as well as for taking security from abroad as guarantee of a domestic loan.

A maximum surcharge of 30 percent of the amount of transaction must be paid when the agreed period of credit for imports is more than 6 months but at most 12 months. High penalties must be paid for unauthorized loans.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Remittances of dividends and profits and the repatriation of capital require advance approval of the Bank of Finland. However, permission is normally granted if the corresponding investment was made with the Bank of Finland's permission.

There are no restrictions on the repayment of foreign loans or the remittance of related interest, provided that the loan agreement has the approval of the Bank of Finland. Royalties based on normal royalty agreements may be remitted. Approval of the agreement is not required.

EMPLOYMENT RESTRICTIONS:

The managing director of a limited liability company and at least two-thirds of the members of the Board of Directors must be Finnish nationals residing in Finland, unless an exception is granted by the Ministry of Trade. Such an exception is normally granted on application.

Aliens, other than nationals of the Nordic countries, must obtain work and residence permits.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

No special privileges are offered to foreign investors.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: FRANCE

INTRODUCTION:

The French government is favorably disposed to foreign investment in most economic sectors. It reserves the right, however, to evaluate each investment and, where deemed politically or economically advisable, to find a "French solution".

However, under certain conditions this unilateral right no longer applies to investments from EEC countries.

Generally, if a direct investment application of a foreign investor is refused, this is because the potential investment is in a branch related to national defense or is considered to be strategic to the economy. Futhermore, considering the condition of the domestic market in certain areas, the administration tends to refuse applications. Japanese investment applications, for example, are subject to great scrutiny.

Generally speaking, considering their possible impact on the French market and despite the political changes which happened recently, the French government is still willing to attract foreign investment, especially if it creates employment opportunities.

All forms of doing business are available to foreigners, as are tax and non-tax incentives.

Provided that taxes are paid and formalities are met, profits and capital may be repatriated without difficulty.

OWNERSHIP RESTRICTIONS:

There is no ownership restriction when the acquisition is not considered as a direct investment or when such an investment has been approved by the government (see exchange control below). However, there is no possibility to acquire or dispose of public state land or publicly owned chattels and movable goods. In addition, certain activities are under state monopoly, such as mining, air and road transportation, postal activities and broadcasting. These are subject to government concession.

These restrictions are not specific to foreign investors. In addition to these overall restrictions, the government does not permit direct foreign control of certain industries (i.e., armament and nuclear industries) and otherwise restricts foreign control at a reasonable level.

EXCHANGE CONTROLS:

Operations in foreign currency as well as all transfers abroad must be made through authorized banks.

Prior approval from the Ministry of Finance (Treasury) is required for direct investments in France, except when made by EEC country residents.

Loans which are not considered as direct investment may be made without prior approval from the Ministry of Finance. They are subject to prior approval from the Central Bank (Banque de France) when they exceed 10 millions FF.

Loans which are considered as direct investment are not subject to prior approval from Ministry of Finance up to 5 millions FF.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be regularly authorized by the Ministry of Finance in order to ensure repatriation rights.

Capital- Provided that the inward investment was properly authorized, there is no restriction on repatriation of capital except in the case of total or partial liquidation of an investment through the sale of shares by a nonresident to a resident for a value of 1 million FF or more. The Treasury has one month to decide if it will refuse or delay the transfer.

Other payments- There are no restrictions on the payment of dividends:

- Branch profits - No restriction provided the creation of the branch was authorized.
- Loans and loan interest - No restriction provided the loan agreement was properly authorized.
- Other interest - No restriction provided proper documentation is produced.
- Royalties - No restriction provided the underlying technology agreement is disclosed.
- Service fees - In order to transfer service fees abroad, the underlying contract must be disclosed and proof furnished that service was rendered and that the amount is due.
- Import of goods - Invoice and customs declarations (Form CA 1) are necessary for payment.

EMPLOYMENT RESTRICTIONS:

Residence and work permits are required for foreign personnel hired on either a permanent or temporary basis.

Work permits are not delivered by labor authorities if employment could be fulfilled by French nationals, but exceptions may be made for higher skilled employees.

Generally, an employee with a salary of an amount under F. 12,000 per month will not obtain a work permit in France.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Direct investments should be approved by the Ministry of Finance. Capital investments into or out of France or their liquidation are subject to government control. This does include purchase, creation or extension of businesses, branches or any personal enterprise.

Investment applications are made with the Treasury.

Foreign investors must report to the Treasury on a yearly basis with a balance sheet and other accounting documents.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

There are no general tax incentives or concessions to encourage investment in France, but there are a variety of regional tax and non-tax incentives such as a Regional Development Grants up to 25 percent of the amount invested. Such grants are based on the number of new jobs created.

An additional non-industrial grant can be obtained on the same basis. This grant should not exceed F. 20,000 per new job.

Purchase of assets made by French operating entities allows up to 1985 deductibility of 10 percent of the purchase price of said assets.

NON-TAX INVESTMENT RESTRICTIONS IN SELECTED COUNTRIES

COUNTRY: WEST GERMANY

INTRODUCTION:

German federal authorities adopt a neutral attitude towards foreign investment and do not offer incentives; nor do they discourage foreign entities from setting up local manufacturing or other business operations. Foreign enterprises establishing in the Federal Republic are not subject to discriminatory provisions. They have the same rights and obligations as German enterprises, and there are no regulations prohibiting foreign corporations from owning the total capital stock of a German company.

OWNERSHIP RESTRICTIONS:

There are no specific restrictions on operations of nonresidents or foreign-held companies, apart from licensing requirements which also apply to residents who want to engage in certain operations (e.g., banking, insurance, forwarding agents).

EXCHANGE CONTROLS:

The federal bank (Bundesbank) is legally authorized to supervise the implementation of exchange control measures under the foreign trade law. It is normally empowered to restrict transactions with non-residents, including investments in German companies. But in fact this authority is not exercised and accordingly such transactions, including the formation of or the acquisition of

interests in German companies, and the transfer of profits abroad and repayment of capital to non-resident investors are not controlled. However, there exists a reporting system for larger receipts and payments in foreign currencies, and foreign investors who acquire more than 25 percent of an existing company's capital must report this to the competent state central banking authorities (Landeszentralbank) for statistical purposes. The federal bank could impose restrictions at short notice, if necessary.

REPATRIATION OR REMITTANCE RESTRICTIONS:

At present, there are no exchange control restrictions on the repatriation of capital and earnings or other remittances abroad, apart from the registration requirements stated under exchange controls.

EMPLOYMENT RESTRICTIONS:

Foreign subjects other than from the European Economic Community (EEC) countries must apply for residence and work permits if they wish to take up employment in Germany. The issuance of work permits to foreign workers from non-EEC states is restricted, with the exception of certain types of employment where a shortage of labor exists. Subjects of EEC countries obtain residence permits upon registration and do not need work permits.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

The establishment in Germany of a branch operation of a foreign non-EEC corporation requires the permission of the Ministry of Commerce in the state in which the branch is to be opened.

An essential precondition for the granting of the permit is the proof of adequate capital for the planned operation.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

There are no incentives which exclusively apply to foreign investment.

Besides various tax incentives, there are numerous incentives offered in Germany to promote business enterprises which either invest or expand in certain locations (e.g., Berlin or the eastern border zone) or engage in certain activities (e.g., research and development, mining). The main types of non-tax incentives are cash grants, and low interest loans. Guarantees by the government-sponsored insurance company are granted to cover political risks of non-collectibility of export proceeds in certain cases.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: GREECE

INTRODUCTION:

Greece actively encourages foreign entities to set up local manufacturing operations. This policy is part of an overall effort to industrialize Greece and to provide employment for its nationals. Greece is also attempting to induce reinvestment of profits in the country. Therefore strict exchange and repatriation controls are imposed to limit the outflow of capital. With respect to companies resident in EEC countries, restrictions on exchange and remittances as well as movement of labor are expected to be eliminated.

OWNERSHIP RESTRICTIONS:

The Government operates certain monopolies--the most important of which are the production and distribution, through subcontractors, of matches and salt. In addition the Government has exclusive rights to operate and own certain oraganizations and companies such as the airline network, telecommunications and post office, electricity production and distribution, radio and television network, sugar industry, and railroads.

In general neither local nor foreign banks can purchase or own shares of Greek banks without government approval. In certain specialized banks (shipping and export) a majority of shares may not be held by foreigners.

Foreign ownership of Greek shipping companies cannot exceed 49 percent of share capital.

The majority of members of the board of directors in a Greek insurance company must be Greek citizens.

Mutual funds cannot be administered by a foreign company.

Foreign ownership of Greek mining companies and the establishment of a foreign mining enterprise in Greece require special government permission.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through the central bank or banks authorized to deal in exchange. In general, the government exercises stringent controls and requires approval for all remittances abroad.

A forward exchange market exists for strictly commercial purposes with a maximum forward period of six months.

For certain categories of imported goods, importers are required to prepay all or part of the CIF value and to deposit certain amounts as security for payment of customs duties upon placement of order.

Funds of foreign companies which have discontinued operations in Greece as well as rentals payable to non-residents must be deposited in a blocked account. Payments from blocked accounts can be made for local expenditures after approval by the central bank. Proceeds from exports must be converted into local currency. Violation of exchange control regulations is a penal offense.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments and loans must be registered with and approved in advance by the Government to ensure repatriation rights.

Profits and interest can only be remitted in respect to previously approved investments and loans and within certain limits. Royalties, management and other fees connected with the investment may also be remitted if provided for in the instrument of approval.

Greece is obligated to eliminate in various stages from January 1, 1981, repatriation and remittance restrictions relating to investments made in Greece by EEC residents, but implementation is still pending.

EMPLOYMENT RESTRICTIONS:

In general, foreigners cannot work in Greece. However, for certain professions (technicians and specialists required by industry) temporary work permits can be obtained. Companies operating under special agreements with the Government may employ a specified number of foreigners, and in those cases work permits are granted readily.

Companies engaged exclusively in business activities outside of Greece under Law 89/1967 may employ foreign personnel without any restrictions.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Greece has established a wide variety of incentives to investment which vary depending on the nature of the investment, the location of the facilities and the industry involved. The main incentives relate to investments in manufacturing, mining and hotel operations located outside the main urban areas. Depending on the area, these take the form of subsidies of 20 percent to 50 percent of the cost of plant and machinery, refund of 30 percent to 50 percent of interest payable, non-taxable reserves, accelerated depreciation and other tax-related incentives.

For new investments over Dr 150 million in productive enterprises and subject to Government approval, incentives include freezing of income tax rates for ten years under certain conditions and exemption from taxes, duties, etc., payable on imported machinery and equipment.

Other incentives include interest refunds for companies exporting manufactured products and subsidies for shipbuilding companies.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: GUATEMALA

INTRODUCTION:

Guatemala actively encourages foreign entities to set up local manufacturing operations. This policy is part of an overall effort to industrialize Guatemala and to provide employment for its nationals. Guatemala is also attempting to induce reinvestment of profits in the country. Therefore exchange and repatriation controls are imposed to limit the outflow of capital, although these controls are somewhat relieved with respect to companies organized in the other Central American countries. On the other hand, a tax incentive by way of a special deduction is allowed to industries for amounts invested in fixed assets. Locally owned businesses are given priority in competition for government contracts.

OWNERSHIP RESTRICTIONS:

The law restricts operation of foreigners in a limited number of fields.

Technology agreements are subject to government appraisal of necessity of service to be rendered and local availability of technology involved.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks.

Prior approval of Banco de Guatemala (the central bank) is required for repayment of all foreign currency loans.

The normal fine for infringement of exchange controls is 100 percent of the amount of the related transaction, but higher fines are also applicable.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the government to ensure repatriation rights.

Capital, loans and technology agreements must be registered to ensure remittance rights.

Any new investment or capital increase must be reported to the central bank.

Profits may only be remitted on capital brought into Guatemala or on reinvestments of profits derived from such capital.

Remittance of dividends and branch profits on registered foreign investment is subject to a flat 10 percent withholding (income) tax.

Royalties may be remitted by a Guatemala subsidiary to a foreign parent, but require prior approval from the government to be deducted for tax purposes.

Remittance of service fees is subject to government verification that services have been effectively rendered.

(Last two items subject to 12.1 percent withholding tax).

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

Ninety percent of employees in terms of number and 85 percent in terms of remuneration, of all commercial, industrial or other enterprises must be nationals of Guatemala. Exceptions may be made for skilled laborers and technicians.

In event of layoffs, nationals of Guatemala whose duties are identical to those of foreigners must be given preferential treatment as regards retention.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Component parts for machinery produced in Guatemala must be manufactured locally unless a specific waiver is obtained from the Ministry of Economy.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Guatemala provides tax holidays to companies establishing manufacturing operations in the country. These holidays are granted in accordance with the Central American Agreement of Incentives for Industrial Development, of which Guatemala is a signatory country. In addition, a law has been enacted whereby draw-back industries established in the Free Zone of Santo Tomas in northeastern Guatemala are granted full exemptions from income

taxes and import/export duties. Also, a law aimed at descentralizing industries is in force. Under this law, new industries established (or, if existing, relocated) outside the Department of Guatemala, where the capital city is located, are granted full import duties and progressively lower income tax exemptions for up to ten years.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: HONDURAS

INTRODUCTION:

Honduras encourages foreign entities to set up local operations. This policy is part of an overall effort to industrialize Honduras and to provide employment for its nationals. Honduras is also attempting to induce reinvestment of profits in Honduras, and accordingly has adopted special credits for reinvestments of profits in new machinery and equipment. These policies have been in effect for some years, and it is expected that they will continue in the future. Locally owned businesses and foreign capital businesses are given the same treatment in competition for government contracts. In highly technical activities, such as construction of port facilities and other heavy construction projects, preference is given to foreign owned companies.

There is also a free zone in Puerto Cortes, Honduras where foreign companies are given all types of facilities to operate without being affected by local taxes as long as the production is for export.

OWNERSHIP RESTRICTIONS:

Foreign ownership of lumber companies is prohibited. Foreign ownership of mining, fisheries, hunting and wood conversion industries is restricted to 49 percent.

Direct ownership of rural real estate is restricted to 50 miles from the coast.

EXCHANGE CONTROLS:

Prior approval of the Central Bank of Honduras is required for all foreign currency loans.

Currency for foreign transactions over $5,000 must also have the prior approval of the Central Bank.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Remittance of dividends and branch profits are subject to a 15 percent withholding tax.

Royalties, fees for services, interest and other charges may be remitted outside of Honduras, subject to a withholding tax.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

Ninety percent of employees of all commercial, industrial or other enterprises must be nationals of Honduras in terms of number and 85 percent in terms of total remuneration. Exceptions are made for skilled laborers, technicians and management.

LABOR MATERIAL CONTENT REQUIREMENTS:

There are none; however, high local content of materials is favorably regarded by the government.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Honduras provides from 4 to 10 years tax holiday to companies establishing manufacturing operations in the country and 5 to 12 years exemption from import duties on machinery and equipment. In addition, the government provides a subsidy of up to 100 percent of the cost of new industrial machinery and equipment used in manufacturing operations in Honduras when the proceeds for the purchase of the capital assets represent reinvestment of profits.

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NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: HONG KONG

INTRODUCTION:

The essential business characteristics of Hong Kong derive from its philosophy of encouraging free enterprise and a free trade economy. The Hong Kong government makes no distinction between local and foreign companies and welcomes investment from both. In recent years, the government has shown increasing interest in attracting high technology industries from abroad in order to expand the capabilities of local industries and generate additional employment.

OWNERSHIP RESTRICTIONS:

All land in Hong Kong is owned by the Crown. Land leases, including those for industrial land, are sold by the government, usually by public auction. There is no discrimination between local residents and aliens in the matter of holding title to land. Overseas investors wishing to buy leases of industrial land for the establishment of their plant may therefore do so.

The only government-owned enterprises are the postal system, the water supply, the airport, a few car parks, the Kowloon-Canton railway and Radio Television Hong Kong. Nationalization is therefore not a threat, although the public utilities do operate under government franchise. The current situation is not expected to change.

EXCHANGE CONTROLS:

There are no exchange controls in Hong Kong, therefore companies are afforded total flexibility in the movement of capital and the repatriation of profits.

REPATRIATION OR REMITTANCE RESTRICTIONS:

None

EMPLOYMENT RESTRICTIONS:

Except for those born, naturalized or registered as British in Hong Kong, all other persons are subject to immigration controls and require visas before entering into employment in Hong Kong. Visas must be obtained from British consulates before departure for Hong Kong. Such visas are usually issued for six months in the first instance and are renewable thereafter every six months.

There are no requirements for local rather than foreign personnel to be employed, and, in practice, employment visas for the latter are easily obtained.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: INDIA

INTRODUCTION:

India welcomes foreign investment only on terms considered by the Government to be in the national interest. As a rule, majority ownership in industries where foreign investment is permitted should be in Indian hands, although the Government may make exceptions in highly export oriented and/or sophisticated technology areas. The Government does not favor the conduct of operations of foreign companies through a branch or a wholly owned subsidiary; and existing foreign companies, other than banks, have generally been converted into Indian companies in accordance with Government directives. The functioning of branches of airlines and shipping companies are decided on the basis of reciprocity. For all approved foreign investments, there is complete freedom for remittance of profits and dividends as well as for repatriation of capital, after compliance with formal procedures.

OWNERSHIP RESTRICTIONS:

Certain industries such as railway wagons, paper and pulp, etc., are closed to financial or technical foreign collaboration, because it is considered that indigenous technology is fully developed. The Government has issued an illustrative list of such industries.

Certain industries such as atomic energy, railway transport, etc., are closed to private enterprise or foreign investment, and new units can be set up only by the State.

The maximum foreign shareholding of Indian Companies is normally restricted to 74, 51 or 40 percent, depending upon the nature of business activities. The most frequent ceiling on foreign shareholding is 40 percent, relaxable in highly export oriented and sophisticated areas. The ceiling may exceed even 74 percent in highly sophisticated areas in export promotion zones.

Permission of the Reserve Bank is required for transfer of shares in an Indian company from any non-resident, either to another non-resident or a resident.

EXCHANGE CONTROLS:

Exchange control in India is exercised under the Foreign Exchange Regulation Act of 1973 by the Exchange Control Department of the Reserve Bank of India.

Operations in foreign currency may be effected only through banks and other organizations authorized to deal in foreign exchange.

Permission of the Reserve Bank is required by a non resident foreigner, non-resident Company or an Indian Company in which the non-resident interest is more than 40 percent to engage in various activities connected with doing business in India. These include the establishment or continuance of place of business, acquisition of immovable property other than short term leases, purchase of shares of Indian Companies either from a resident or a non-resident, acquisition of any interest in any business in India, borrowing of money from a person resident in India, and

the acceptance of any appointment as agent, technical or management adviser. Banking companies are, however, exempt from many of these restrictions.

Companies with direct non-resident shareholding not exceeding 40 percent are treated on a par with Indian companies.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Repatriation of investments is permissible, provided that the disinvestment has been made with the approval of the Government of India and the Reserve Bank of India, and that it is in accordance with the approved conditions regarding installments and principal. There are, however, no published guidelines covering the cases of repatriation of capital, and each case is decided on its own merits. Remittances can be made in full after completing necessary exchange control formalities for dividends, interest, technical know-how, fees and royalties in respect to approved collaboration agreements, branch profits and import of goods. Most of the remittances can be made only with the prior approval of the Reserve Bank. Some types of remittances, such as interest on government securities, bank deposits, dividends on equity shares up to a limited shareholding, dividend on preferred stocks can be made without the Reserve Bank's approval if the prescribed conditions are fulfilled.

Banks that are authorized dealers in foreign exchange may allow all non-Indian nationals temporarily resident but not domiciled in India to make remittances to their own countries up to Rs2500 a month per individual, provided that the authorized dealer making the remittance is satisfied that this amount does not exceed 50 percent of the remitter's net income after taxes. If an application is made for remittance of an amount in excess of

the sum indicated above, it must be referred to the Reserve Bank. The Reserve Bank is prepared to consider individual cases on their merits and to allow remittances on a higher scale when satisfied that the applicant has retained sufficient funds out of his monthly income to meet his expenses in India.

Foreign nationals temporarily residing in India are allowed, when they finally leave India, to remit current assets, such as savings out of salaries, commissions, dividends, provident funds and sale proceeds of personal effects, in full. In addition, they may be permitted to repatriate the sale proceeds of their investments, subject to a limit of Rs1,000,000 at the time of their leaving India and the balance, if any, may be remitted in annual installments not exceeding Rs50,000 per annum.

All remittances have to be made through normal banking channels.

EMPLOYMENT RESTRICTIONS:

Visas and work permits are required for all foreigners excepting British nationals.

A foreign national wishing to take up employment, practice a profession or carry on an occupation, trade or business in India must obtain prior permission of the Reserve Bank if he wishes to remit part of his earnings outside.

The Government of India has not introduced any legislation to provide for the Indianization of employment. However, those companies employing foreigners are asked to make voluntary reports as to the numbers of foreigners and Indians employed in different salary grades; and the Government has published certain targets for Indianization which employers have been urged to achieve voluntarily.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There is no specific requirement regarding local material content in a manufactured item, but imports are subject to license.

OTHER RESTRICTIONS:

All proposals involving foreign technical and financial participation must be cleared through the Foreign Investment Board of the Government of India. Applications must be submitted to the Secretariat for Industrial Approvals. If the proposal involves issue of shares to non-residents and the total capital to be raised exeeds Rs 5 million in a year, a simultaneous application should be made to the Controller of Capital Issues under the Ministry of Finance. After the collaboration proposal is approved by the Government and the consent of the Controller of Capital Issues and clearance under the Monopolies and Restrictive Trade Practices Act are obtained as necessary, formal authorization or permission to issue shares is given by the Reserve Bank of India.

Following are some of the important guidelines, in addition to ownership restrictions, for approval of proposals for financial and/or technical collaboration agreements:

- Foreign share capital should be in cash without being linked to imports of machinery and equipment or to payments for know-how, tradmarks, brand names, etc.

- The percentage of royalty allowed in a technical collaboration depends on the nature of the technology but should not ordinarily exceed 5 percent. Royalty is taxable. It is calculated on the basis of the ex-factory selling price of the product net of excise duties and after deducting the cost of standard bought-out components and the landed cost of imported components. Wherever appropriate, payment of a fixed

amount of royalty per unit of production is preferred. There should be no requirement for the payment of minimum-guaranteed royalty regardless of the amount and value of production.

- Suitable lump-sum payments, in addition to the recurring royalty, are considered in deserving cases for the import of drawings, documentation, and other forms of know-how.

- Collaboration agreements are normally approved for a period of five years from the date of agreement, or five years from the commencement of production, provided production is not delayed beyond a period of three years from the signing of the agreement (i.e. a maximum of eight years from the date of signing of the agreement).

- The entrepreneur is expected to furnish reasons for preferring the particular technology and the source of import.

- The technical collaboration agreement should generally not prohibit sublicensing of the know-how/product design/engineering design to other Indian parties.

- There should not be any restriction on the Indian company in the matter of procurement of capital goods, components, spares, raw materials, pricing policy, selling arrangements, etc.

- The collaboration agreements should not place any export restrictions on the Indian party. The Indian party will be free to export to countries except where the collaborator has a sublicensing arrangement.

- There should be no provision for the use of foreign brand names on the products for internal sale, although there is no objection to their use on products to be exported.

- In case any consultancy is required to execute the project, it should be obtained from Indian consultancy firms. If foreign consultancy is also considered necessary, an Indian consultancy firm should nevertheless normally be the prime consultant.

- If the proposed item of manufacture is covered by a patent in India, the collaboration agreement should include a clause to the effect that the payment of royalty for the duration of the agreement would also

constitute compensation for the use of the patent rights until the expiration of the life of the patent, and that the Indian party would have the freedom to produce the item even after the expiration of the collaboration agreement without any additional payments.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

No distinction is made between domestic and foreign investors in the matter of subsidies or other incentives:

Non-tax Incentives

Several non-tax incentives are offered by Central and State governments in the interest of development of backward areas, exports, or some specific industries, such as plantations. Industrial units set up in specified backward districts are eligible for (a) a 15 percent Central Government subsidy on their fixed capital investment or Rs.1.5 million, whichever is less, and for (b) concessional financing from national financial institutions. The Central Government also grants transport subsidies in certain selected areas. In addition, the State Governments offer various types of incentives and facilities, such as land on concessional terms, water and power at reduced rates, concessions in sales tax and octroi (taxes on commodities), and other subsidies.

Export incentives take the form of cash assistance or cash compensatory support on exports of certain items; duty drawback, i.e., refund of central excise and customs duties levied on raw material and components used in the manufacture of exports; import replenishment to replace imported raw materials and components used in the manufacture of exports; airfreight subsidy on export of certain products; special treatment for export-oriented units for import of raw materials; and credit

facilities from approved financial institutions at preshipment and postshipment stages.

Tax Incentives

Some of the tax provisions that have the effect of encouraging investments in India by domestic and foreign investors are the following:

- In addition to depreciation, investment allowance is deducted in computing taxable profits at 25 percent of the cost of machinery and equipment in the year of installation under certain circumstances.

- Capital expenditure on scientific research is deductible in full in the year of incurrence. Certain other capital expenditure (e.g. preliminary expenses and expenditure on prospecting for specified minerals) can be amortized over ten years and, in the case of patents/trademarks, over fourteen years.

- New industrial undertakings commencing manufacture after March 31, 1981, but before April 1, 1985 (or approved hotels that start operations within these dates or ships brought into use within these dates) will enjoy exemption from income tax on 25 percent of the profit of such undertaking (or hotel or ship) in the case of companies (20 percent in cases of non-corporate taxpayers) during the first eight years on certain conditions. In addition to the above, 20 percent of the profits of newly established industrial undertakings or hotel businesses in specified backward areas and 20 percent of the profits of newly established small-scale industrial undertakings in rural areas are exempt from income tax during the first ten years.

- Foreign companies are taxed on dividends received from Indian companies at 25 percent, which is comparatively lower than the tax rates on other types of income.

- Individuals subscribing to the first public issue of shares by certain types of companies can deduct 50 percent of the cost of such investment, or Rs.5,000, whichever is less, when computing their taxable income.

- Individuals enjoy exemption from wealth tax for five years in respect to investment in equity shares of companies engaged in specified high-priority industries. This apart, shares in Indian companies, along with certain other financial assets, are excluded from net taxable wealth up to Rs.150,000. Indian citizens not resident in India enjoy full wealth-tax exemption in respect to investment in equity shares of certain Indian companies.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: INDONESIA

INTRODUCTION:

The government allows foreign investment in Indonesia on a selective basis as a means to assist in the planned economic development of the country. The policy trend is to consider foreign investment as a method of importing modern technology and developing the local entrepreneurial ability, of Indonesian nationals. Within this context the government is actively seeking new foreign investment, albeit on an increasingly selective basis as more activities are considered able to be handled by existing expertise and capital sources.

OWNERSHIP RESTRICTIONS:

Foreign investment is not allowed in the fields of defense industries, mass media and the refining, distribution and marketing of petroleum products.

Public infrastructure activities such as communications, water supply, railroads, etc. are generally not open to a controlling foreign investment participation.

Foreign companies cannot operate directly in any aspects of trade or distribution in Indonesia.

For other fields the government publishes annually a list of Priority Scales for Foreign Investment which details which

particular areas are open for foreign investment and what conditions apply to such foreign investment.

In general, all new foreign investment must be on a joint venture basis with an Indonesian partner, and the Indonesian shareholding should be increased to 51 percent within 10 years of commencement of operations.

EXCHANGE CONTROLS:

Foreign investors generally may freely transfer funds to and from abroad.

REPATRIATION OR REMITTANCE RESTRICTIONS:

The foreign investment plan approved by the government must contain details of the company's share capital, loan capital, technical assistance agreements and management agreements. The movement of funds into Indonesia, to satisfy the investment plan, must be registered with Bank Indonesia.

Repatriation of investors' share capital is generally not allowed while the company is within an Indonesian tax holiday. An exception is made where the funds remitted are derived from a sale of shares to Indonesians.

EMPLOYMENT RESTRICTIONS:

The foreign investment law allows employment of expatriates, but only in positions that cannot be filled by Indonesian nationals and if regular and systematic training will be provided to allow gradual replacement of expatriates by Indonesians. The government urges foreign investors to train Indonesians for

managerial and technical positions at all levels, and it is expected to tighten its policies in this area.

Specific Indonesianization programs may be written into the project agreement between the foreign investor and the government.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no general rules on the use of local material content, although the principle is encouraged by the government. Specific requirements vary among industries and in individual cases.

OTHER RESTRICTIONS:

Where a foreign joint venture is established in the field of agriculture or plantations, the land title purchased from the government for such activity must be held in the name of the Indonesian partner and not in the name of the joint venture company.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

There are a number of incentives for foreign investment which can be obtained, the extent of the incentives granted usually depending on the priority which the government places on a particular activity.

The incentives available may include:

- Tax holidays between 2 to 6 years;
- Investment allowance of 20 percent of investment expenditures;

- Corporate tax rate reductions;
- Withholding tax exemption or reductions;
- Exemption from duties and tax on certain imports;
- Exemption from stamp tax on share capital.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: IRELAND

INTRODUCTION:

For twenty years, successive governments have actively sought and encouraged foreign investment in Ireland. This trend is continuing and is part of an overall plan to broaden the industrial base and to provide employment for the young and increasing workforce.

A state sponsored agency, the Industrial Development Authority (IDA) is specifically charged with the task of assisting industrialists from abroad to establish manufacturing industries in the Republic. There is a plentiful supply of young, educated and English speaking labor.

The Irish economy is based on the principle of private ownership. There are no restrictions on the percentage of foreign ownership, and in general foreigners are as free to carry on business as citizens of the Republic.

OWNERSHIP RESTRICTIONS:

Industries which require a national base should be regarded as being closed to private enterprise. These would include:

- Railroads
- Passenger bus services

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- Electricity generation and distribution
- Telephone services
- State broadcasting services.

The reason for this is the importance of those industries to a small economy such as Ireland's.

Restrictions are placed on the operation of a banking service. A license must be obtained from the controlling Authority (Central Bank of Ireland). No distinctions are made between applications from foreign or native individuals. Each application is assessed on merit against standard criteria.

A company must obtain a license from the government before it can engage in the exploration of off-shore oil and gas. License holders must undertake exploration programs on an agreed basis.

There are no restrictions on the purchase by foreigners of land and properties in the cities and larger towns, but consent may be required for the purchase of certain land outside the urban areas.

EXCHANGE CONTROLS:

The Central Bank of Ireland is responsible for the administration of exchange controls. The legislation governing exchange control is the Exchange Control Acts 1954/1978.

Certain powers in relation to routine financial transactions (such as current trade payments, certain movements of personal

capital, etc.) have been delegated to Authorized Dealers and Approved Agents. Current trade payments are supervised rather than restricted.

Irish companies, public or private, and Irish branches of foreign companies require permission from the Central Bank for borrowing outside Ireland.

REPATRIATION OR REMITTENCE RESTRICTIONS:

Direct investment in Ireland by non-residents requires prior exchange control permission. Such permission is readily given.

Permission is normally forthcoming for the issue of shares in an Irish private company to non-residents upon production of a certificate from an Irish bank that the full purchase price has been paid, either in foreign currency or Irish pounds, from an external account.

Where an authorized investment has been made by non-residents, permission is readily given for the transfer of dividends/profits outside the state.

Approval is readily given for the repatriation of the sale or liquidation proceeds of authorized investments.

Prior exchange control permission must be obtained to enter into royalty and other agreements (including licensing, technical and management assistance, and servicing agreements) with non-residents of the state and to make payments under the terms of such agreements.

EMPLOYMENT RESTRICTIONS:

Work permits are not required by EEC nationals intending to work in Ireland. Nationals of other countries require permits. The controlling authority is the Department of Labor.

Persons coming to Ireland from outside the EEC should have work permits arranged before arrival. The Irish employer must make the application on behalf of the individual and must satisfy the Department of Labor that no Irish national is available with suitable qualifications for the job. Work permits are issued for periods of one year and are renewable.

Foreign firms setting up in Ireland are unlikely to have any difficulty in obtaining permits for key personnel, as a very positive attitude is taken by the Department of Labor in these circumstances.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Cash grants are available towards the establishment of new manufacturing industries. The more important grants are:

Capital Grants, towards the cost of eligible fixed assets (land, buildings, new plant and equipment) for approved industrial undertakings. The maximum grant percentage possible is 60 percent in the underdeveloped areas and 45 percent in other areas of the country.

Training Grants, towards the cost of training employees in connection with an approved undertaking. Eligible costs include wages and salaries, travelling and living expenses of employees sent abroad for training, and the cost of sending personnel to Ireland to train staff here. The grants are negotiable up to 100 percent.

Research and Development Grants, towards the cost of approved R & D projects. Grants may be negotiated up to 50 percent of eligible costs (salaries, materials, consulting fees and capital costs such as buildings, equipment or pilot plant which will form the basis of a permanent research unit) up to a maximum of 250,000 (British pound sterling) for any one project.

Other incentives are available in the form of tax concessions and relief. These include:

- Accelerated Tax Depreciation allowances of up to 100 percent on the full cost of new plant put into use during an accounting period;
- Favorable Tax Based Finance, including leasing of machinery and equipment; and

o A reduced rate of corporation tax of 10 percent applicable to profits from goods manufactured in Ireland from January 1, 1981, to December 31, 2000. This relief is available only to companies.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: ITALY

INTRODUCTION:

The government has a favorable attitude towards foreign investment. In general, all usual methods of carrying on business are open to foreign investors, i.e. licensed trading, importation, proprietorships, partnerships, and manufacturing through a branch or a subsidiary. Tax and non-tax incentives are available to all investors, foreign as well as Italian. Law 43 of February 7, 1956 guarantees that funds brought into the country under its protection may be repatriated. If the funds are brought into Italy in a foreign currency, the law will make the same currency available for their eventual repatriation. Profits may be remitted freely in terms of the law. There is no discrimination between local and foreign owned business. There is no statutory restriction on the percentage of foreign ownership of any local enterprise or joint venture, except in aircraft operating and shipping companies. Under the present government, there is no indication that the restrictions on foreign ownership are likely to become less liberal.

OWNERSHIP RESTRICTIONS:

In general, there are no prohibitions on the ownership by foreigners of any capital investments, except in the activities listed below.

Banks:

Branches of foreign banks may establish branch offices only with the permission of the Bank of Italy. For "Banks of national interest" foreign shareholders may not vote at meetings.

Insurance:

Prior government authorization is required to carry out life and property insurance. It may be granted if the other country grants the same reciprocity to Italian companies abroad. The foreign company must (a) prove that it has been active in life and property insurance for not less than ten years, and (b) appoint a general agent in Italy, who must be an Italian citizen resident in Italy.

Scheduled Airlines:

Scheduled airline services may be operated only by persons, agencies or companies qualified to own Italian aircraft. Foreign companies are entitled to buy a shareholding not exceeding 40 percent of the total share capital.

Aircraft:

Registration in the National Aircraft Register is required and is limited to aircraft owned by Italian citizens or by companies in which foreigners hold not more than 40 percent of the total share capital.

Shipping:

Italian ships may be owned only by companies established and managed in Italy and for which it is ascertained that Italian citizens are in a majority position in both shareholding and in administration and management.

EXCHANGE CONTROLS:

In general, all foreign exchange transactions are subject to the control and supervision of the Italian Foreign Exchange Control Office (Ufficio Italiano dei Cambi) known as CAMBITAL.

Loans from abroad, in general, require advance permission from the Ministry of the Treasury. The authorization normally lays down conditions regarding repayment terms, including a provision that repayment may not commence until a certain period (usually three years) has elapsed since the date of the loan. Interest rates in excess of 8 to 10 percent would not normally be permitted. Prior authorization, however, is not required for certain types of loans granted by residents of the countries comprising (a) the European Economic Community (EEC), and (b) the Organization for Economic Cooperation and Development (OECD).

Strictly speaking, the registration of a technology agreement is not necessary. However, in order to facilitate the repatriation of later earnings or royalties based on the agreement, the original agreement should be shown to the payer's bank. The bank, acting as an agent for Exchange Control, would be able to pay the remitted royalties or profit to the overseas company.

In order to restrict the large outflow of currency, stringent laws were enacted in 1976 which considerably increased the penalties for violation of the exchange control regulations, and also introduced criminal sanctions (fines, jail) in this connection.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There continue to be some restrictions on remittances from Italy, but foreign exchange can at present be readily obtained for settlement of current commercial transactions.

Law No. 43 guarantees repatriation of foreign capital and unlimited remittance of related earnings, in respect to investments made for the purpose of establishing or expanding

"productive" enterprises after the law came into force. The only restriction imposed is that where the capital investment was made by way of introduction of machinery, capital repatriation may not take place until two years after the date of the original investment.

The phrase "for the purpose of establishing or expanding 'productive' enterprises" is significant. If the introduction of foreign capital is for the purpose of acquiring an investment in an existing Italian enterprise, with no element of expansion involved, the investment is not eligible for preferential treatment even if the enterprise falls within the "productive" definition.

Presidential Decree No. 758 of July 6, 1956, which lays down operating procedures for the implementation of Law No. 43, defines "productive" enterprises in broad terms as including, inter alia, those whose objects are the production of goods and services, construction projects, use of ships and aircraft, and construction of buildings (including hotels) and roads. The list given in the decree is not exhaustive, and activities not specifically mentioned therein may nevertheless be deemed to fall within the definition, subject to interpretation of the Ministry of Treasury.

The fact that an investment is "productive" within the meaning of the law does not automatically entitle the foreign investor to the benefits accorded by the law. The necessary administrative procedures must also be followed. These include:

- Application to the Ministry of Treasury, before the investment is made, for a provisional declaration that the investment falls within the "productive" definition.

- Application again to the Ministry of Treasury, after the investment has been made, for a definitive certificate. This will be issued, within 90 days of the application, after the Treasury is satisfied that the investment has in fact resulted in the establishment or expansion of a "productive" enterprise within the meaning of the law.

Nonproductive investments are all investments, made after Law No. 43 came into force, which do not qualify for the "productive" definition, and all investments made in accordance with the provisions of the Decree Law No. 211 of March 2, 1948. For these investments, Law No. 43 guarantees (a) remittance of earnings up to 8 percent per annum on the foreign capital invested, and (b) repatriation of capital not exceeding the amount of foreign currency originally introduced, subject to the condition that such repatriation may not take place until two years after the date of the original investment. The 8 percent limit is not presently operating, and therefore no limit in repatriation of profit exists.

There are no special exchange rates for foreign currency which give benefits to inward investment as opposed to the general buying and selling rates for any currency.

EMPLOYMENT RESTRICTIONS:

The regulations governing the employment, movement and stay of foreign workers in Italy distinguish between foreigners generally and nationals of States belonging to the European Economic Community.

A) Foreign workers in general

Employment in Italy involves the following formalities:

1) An entry visa for the purpose of work - the prospective employer must submit an application to the Provincial Labor Office for permission to hire the foreign worker;

2) A labor permit issued by the Provincial Labor Office on the basis of the inquiries made in connection with the granting of the visa;

3) A stay permit on grounds of work issued by the relevant provincial police headquarters on presentation of the labor permit;

4) A labor card for which the employer applies to the local Labor Inspector; and

5) A final OK to hire granted by the Provincial Labor Office which enters the foreign worker's name in the employment lists.

B) Foreign workers who are nationals of EEC member states

In line with the Community regulations which aim to achieve free movement of manpower within the EEC, a simpler procedure is adopted.

The right of movement and sojourn of workers and their families is acknowledged by the grant of a document called the "Sojourn card for citizens of an EEC member State."

The card is issued free of charge by the Police Authorities of the place in which the person concerned decides to stay, upon presentation of the following documents:

1) for the worker
-document by virtue of which he entered Italy
-declaration of hiring by the prospective employer (or employment certificate)

2) for the family members
-document by virtue of which they entered Italy
-document issued by the State of origin or provenance attesting the existence of the family relationship

-document issued by the State of origin or provenance showing that the family members are dependents and live with the worker.

The Sojourn Card is valid throughout Italy for five years from the date of issue and is automatically renewable.

Once a worker is in possession of his Sojourn Card he can start work provided that his retrospective employer has applied to the Labor Inspector for his labor card and has notified the Provincial Labor Office so that the foreign worker's name may be entered on the employment lists.

The following need not apply for a Sojourn Card:

-workers who are hired for not more than three months
-seasonal workers
-workers who cross the frontier daily to go to work

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

There are no special incentives for foreign investors. However, incentives normally given to local investors are applicable to them.

NON-TAX INCENTIVES:

General Incentives

Since 1950, the Government has attempted to attract new industrial enterprises to Southern Italy through tax and other incentives. This area, known as the Mezzogiorno, comprises the provinces south of Rome, Sicily and Sardinia, and certain small islands. Non-tax incentives take the form of loans at low rates of interest and outright grants toward capital investments. The benefits are available to all who qualify, Italian or foreign. Other depressed areas and mountain areas of Northern Italy also have schemes for low interest loans.

Regional Incentives

Southern Italy

Companies establishing new industrial plans in Southern Italy or expanding or reactivating existing plants are entitled to apply for grants as follows:

Capital Range in Millions of Lire		Grant
Over	Not Over	%
200	2,000	40
2,000	7,000	30
7,000	15,000	20
15,000		15

Cash grants are extended on the basis of the cost of buildings, connections to utilities, machinery and equipment. The above-mentioned cash grants can be raised by one-fifth when the investment project is in a priority sector, according to government directives. A further one-fifth increase can be granted for projects locating in particularly depressed areas. In any case total financial incentives (soft loans and cash grants) may not exceed 70 percent of fixed investment. The only admitted exceptions concern the above-mentioned cases of priority sectors and special locations for which, therefore, a total maximum of 86 percent is allowed. Cash grants are available for construction of headquarters buildings of companies with plants in the Mezzogiorno.

Grants received in respect of fixed assets are normally taxable. Taxation may be avoided if the grant is credited to a special reserve in the balance sheet which may be utilized only to cover losses. Any other use of the reserve would render it taxable to the extent of its utilization. Fixed assets may be depreciated over the years up to their full cost, ignoring the grant received.

There are other non-tax concessions for new investments in Southern Italy, including reduced rail charges, cheaper electricity, and lower social security charges.

Loans at a low interest rate are extended for industrial investment projects, the cost of which does not exceed Lire 15,000 million. Such loans are equal to 40 percent of fixed investment and inventory (raw or pretreated materials for an amount not exceeding 40 percent of fixed investment). The rate of interest is 30 percent of the official rate, which is fixed

periodically by the Government. The maturity of loans cannot exceed 15 years for new projects and 10 years for enlargement and modernization of existing facilities.

Depressed and Mountain Regions

Other regions declared as depressed areas of Central Northern Italy and mountain zones offer loans for small and medium size industries which are defined as those whose invested capital (defined as property, plant plus working capital) does not exceed Lire 7,000 million or 4,000 million depending on the region. Amount, length and rate of the loan depends also on the region where the enterprise is located and on the destination of loans (fixed investments or inventory).

Tourist Industry

Law 326 of March 12, 1968 gives benefits anywhere in Italy for improvement of the country's hotel and tourist accommodations. They include:

Loans:	at 4 percent on 60 percent of allowable outlay for up to 25 years or up to 10 percent for modernization and furnishing.
Capital Grants:	A maximum of 15 percent of allowed outlay in addition to other forms of aid.

These may be granted to foreign persons or companies.

Export Credits

Special measures are provided to encourage exports. They consist mainly of insurance of export credit at favorable conditions, and financing the exporter vis-a-vis the amount receivable from the foreign customer at an interest rate lower than the market rate.

TAX INCENTIVES:

Inward Investment

In its efforts to encourage investments in underdeveloped areas, the Government has designated certain areas within Italy as depressed and granted tax concessions to investors. It should be noted that the concessions often apply to new or expanding ventures only. A purchase of an existing plant without expanding productive capacity would not qualify for the benefits.

Capital Investment

There is no scheme whereby investments in plant may be depreciated by way of investment allowance to more than 100 percent of cost. However, in the southern depressed areas capital grants can be obtained, free of tax.

Any company operating anywhere in Italy may request an exemption from local income tax (ILOR) of up to 70 percent of profits destined for reinvestment in the southern area. The taxpayer has to furnish proof that the investment is taking place.

Tax Concessions

Regional Concessions

The tax concessions for Southern Italy and other depressed regions take the following form:

Southern depressed areas:

50 percent reduction of corporate income tax (IRPEG), from 25 percent to 12.5 percent, for a period of ten years from incorporation. This concession applies to companies establishing new manufacturing plants.

For manufacturing companies, an exemption from local income tax (ILOR), which is normally 15 percent, for ten years from the first year in which the company makes a profit.

Depressed areas of Central and Northern Italy:

Small and medium-sized manufacturing companies may be exempted from local income tax (ILOR) for a period of ten years. This concession is limited to smaller companies and is only applicable if the investment in fixed assets does not exceed Lire 2,000 million.

Trieste area:

For parts of the province of Trieste, there is an exemption from local income tax (ILOR) for a period of ten years.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: IVORY COAST

INTRODUCTION:

The Ivory Coast actively encourages foreign entities to set up local operations. This policy is part of an overall effort to industrialize and provide employment for its nationals. The Ivory Coast is also attempting to encourage reinvestment of profits in the country through tax exemptions.

Furthermore, the government has been authorized to set up and invest in National companies. When the government invests in private companies, its representatives may however exercise control beyond the level of representation to which they are entitled by their capital participation. Participation by the government or Ivorian interests is widespread and may be expected as a requirement for all significant new investments of foreign capital. While 100 percent foreign ownership is legally permissible, it is usually advisable to conform to the trend of Ivorian participation.

OWNERSHIP RESTRICTIONS:

Foreign ownership of newspapers and television or radio stations is prohibited. Foreign ownership of airlines is restricted. The law regulating banking and finance applies to all financial institutions doing business in the country regardless of their form or nationality. Prior permission must be obtained from the Central Bank and the Ministry of Finance, and is not

automatically granted. Business agents, including real estate and travel agents, are subject to licensing and regulation by the Ministry of Justice, the Ministry of Tourism, the Ministry of Public Works, Construction and Urbanization, and the Ministry of Commerce. Certain professional qualifications must be met. Insurance companies require licensing by the Ministry of the Economy and Finance. Certain requirements as to business form, management, capital, reserves, tariffs and reporting must be met. Insurance covering residents, assets or risks in the Ivory Coast generally must be placed with a locally registered company. The exploitation of forestry and fishery resources is subject to licensing requirements and other limitations. Oil exploration is carried out under production sharing agreements with the government. Concessions and permits are issued by the Ministry of Mines.

EXCHANGE CONTROLS:

The Ivory Coast is a member of the Franc Zone. In addition to France, members include Cameroon, Gabon, the Central African Republic, Chad, the Congo, Mali, Togo, Monaco, and members of the West African Monetary Union (UMOA). The Ivory Coast is also a member of the UMOA regional subdivision of the Franc Zone. The currency of each member is linked to the French franc at a fixed rate of exchange, thereby assuring free convertibility with the French franc. Members must hold most of their reserves in French francs and carry out currency transactions on the French exchange market.

The UMOA has established the Central Bank of West African States (BCEAO) which regulates members' banking and financial relations with specific regard to credit. Therefore, a currency transaction between the Ivory Coast and a country which is not a

member of the Franc Zone is subject to regulations administered by the Financing Office of the Ministry of the Economy and Finance. Prior approval of the Financing Office is required for all foreign currency loans or capital investments. Infringement of exchange control is not punished, because the attitude of the Ivorian authorities is to welcome foreign investments and thus the application of the procedure is quite liberal. However, funds transferred into the Zone without prior approval may not be repatriated.

REPATRIATION OR REMITTANCE RESTRICTIONS:

To insure repatriation rights, a request for approval of all direct investments should be made in the form of a letter submitted to the Financial Office and setting forth information about the investor and the proposed investment.

If the Financing Office considers the investment's capitalization adequate for the purposes proposed, approval is routinely granted within one month after filing the request.

Direct investment includes:

- The purchase or the setting up of a business, or an increase in lines of business; and
- All transactions, when considered alone or in conjunction with other transactions, which have the effect of non-residents taking control or increasing control of a company engaged in a business activity.

Acquisition of an interest not exceeding 20 percent of the capital of a company whose stock is quoted on a public exchange is not considered to be a direct investment.

All transfers of funds must pass through an "intermediare agree," usually a local bank. These include interest payments, rent, dividends, repatriation of capital, and royalties on patents, trademarks, licenses and copyrights.

Foreign employees may transfer out of the country an amount equal to their net salary received (Avis N^{o} 12 of July 31, 1969, modified by Note of December 17, 1969).

Prior approval from the Minister of the Economy and Finance is required for foreign borrowings by residents, except for loans constituting direct investments, loans arranged through "intermediaries agrees," and loans which do not exceed F.CFA 50 millions or where the interest rate does not exceed the local market rate. Profits may only be remitted on capital brought into the Ivory Coast or on the reinvestment of profits derived from such capital. Repatriation of capital in excess of the amount registered in foreign currency with the Central Bank is subject to withholding tax.

Remittance of dividends and branch profits on registered foreign investment is subject respectively to a withholding tax of 12 percent on dividends and 12 percent of 50 percent of branch profits after income tax. Royalties are subject to a withholding tax of 20 percent of gross revenues. Remittance of service fees is subject to taxes on services at a rate of 23.45 percent and to a withholding tax of 20 percent of gross revenues.

EMPLOYMENT RESTRICTIONS:

There are no specific quota requirements in the Ivory Coast defining the minimum number of nationals, but all recruitment must be authorized by the employment office (OMOCI). Normally

the procedure for recruiting expatriates is to start by filing an offer of employment. The offer is recorded and transmitted to a central register of persons looking for jobs.

Where candidates exist, the offer is suspended and OMOCI advises the potential employer of the candidates available. Assuming none are acceptable, the procedure for interrogating the file of job requests continues, unless the company cancels the offer.

Where no candidate exists, the OMOCI will authorize the company to recruit directly.

In the case of non-Ivorians a visa request must be initiated, and a contract of employment must be drafted and submitted for approval before the expatriate takes up permanent residency in the Ivory Coast. The contract is void if approval is refused. The visa request is the responsibility of the employer. If a worker arrives in Ivory Coast to find the visa denied, he would be repatriated at the employer's expense, possibly with damages.

French nationals spending more than 3 consecutive months in the Ivory Coast require permits. For other nationals, compliance with appropriate immigration formalities is necessary. These vary according to nationality.

LOCAL MATERIAL CONTENT REQUIREMENTS:

If component parts for machinery are produced in the Ivory Coast, they must be used in priority over import products unless a specific waiver is obtained from the Department of Commerce, or the quality can be shown to be inferior.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The Ivory Coast provides:

- A 25 year exemption from corporate income tax for enterprises that construct and rent buildings on residential real estate;
- A five year exemption from corporate income tax for enterprises that construct factories;
- A five to 25 year exemption from real estate taxes;
- A five year exemption from the business license tax;
- A ten year exemption from import duties on machinery and equipment used in the business or raw materials;
- A ten year reduction of export duties by 50 percent;
- Enterprises considered as being particularly important to the development of the country may enter into special long term agreements with the government which provide benefits for periods beyond those described above i.e., for a period of 25 years plus an additional five years for starting up operations.

No subsequent change may be made by the government in the tax rates provided for in the agreements.

However, if the tax legislation enacted subsequently by the government proves to be more advantageous to the taxpayer, he may elect to be taxed under the new system.

Incentives for tourism - special incentives are granted to enterprises involved in tourism at the discretion of the government.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: JAMAICA

INTRODUCTION:

Jamaica actively encourages foreign entities to set up local manufacturing operations, preferably in the form of joint ventures with local interests. This policy is part of an overall effort to industrialize Jamaica, to provide employment for its nationals, and to generate foreign exchange by way of capital inflow as well as export earning. As an aid to this program, the government of Jamaica has established a company, Jamaica National Investment Promotions Limited, to promote and facilitate all private investments in Jamaica with priority being given to investments with rapid employment possibilities and foreign exchange potential.

Registration with the Central Bank of Foreign Investments is required to ensure future repatriation of capital and earnings. The registration requirement also provides the opportunity to ensure that the policy of local participation is carried out either immediately or over a certain period of time and to exclude foreign ownership from areas where there is adequate local capability.

OWNERSHIP RESTRICTIONS:

Foreign ownership of public utilities is prohibited, as is the ownership of land for the sole purpose of development for resale.

Foreign ownership in several areas is regulated (e.g. radio, television, banking, insurance institutions and mining), and a license from a government agency is a prerequisite for operation.

Technology agreements are subject to government appraisal to ensure that the cost is commensurate with benefits. Generally speaking, exchange control registration mechanisms operate to channel foreign investments away from areas already adequately served locally.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange. Borrowings and investments from abroad must be approved by and registered with the Bank of Jamaica. Foreign investors require Central Bank permission to borrow locally. Legislation provides fines and/or imprisonment for infringement of exchange control regulations.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments by way of equity or loans must be registered with the Central Bank to ensure repatriation rights. Technology agreements must be approved by the government to ensure remittance rights. Profits may only be remitted on capital brought into Jamaica or on reinvestments of profits derived from such capital. Repatriation of capital in excess of the amount registered in foreign currency with the Central Bank requires special approval.

Remittance of dividends and branch profits on registered foreign investment is subject to tax restraints. Royalties may be remitted to a foreign parent subject to government approval of royalty agreements.

Remittance of service fees is also subject to government approval of the contract and to tax restraints.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis. Work permits are not granted if adequate local labor is available.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Licenses are required for a wide range of imports, and generally the government encourages the use of local products in order to reduce foreign exchange outflows.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Jamaica provides a 10-year tax holiday to companies establishing manufacturing operations in certain approved products. Further relief up to 50 percent of taxable income from export profits may

be granted. A somewhat similar relief program is granted to hotel operations and certain agricultural activities. Financial assistance is provided to exporters in the area of advertising and market research. Exporters also receive priority on foreign exchange for raw materials and equipment.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: JAPAN

INTRODUCTION:

With the recent successful expansion of Japanese economy, the Japanese government has substantially liberalized the movement of most investments into and out of Japan. It is, therefore, anticipated that stringent controls or restrictions like those existing previously would not be instituted unless needed during monetary emergencies. The predominant Japanese policy is to maintain free trade and capital movements. Nationalization would not be welcomed.

In addition to statutory considerations, certain administrative controls by the government, or commercial practices which are accepted as normal under the current Japanese industrial structure and circumstances might be considered as invisible barriers by foreigners.

OWNERSHIP RESTRICTIONS:

The law concerning foreign investment is now integrated into the Foreign Exchange and Foreign Trade Control Law. Direct capital investments by foreign investors in Japanese companies, the substantial ownership of which is to be held for participation purposes, have recently been greatly liberalized. Foreign investors are still required to submit an advance report relating to the acquisition of shares to the competent government ministers through the Bank of Japan. This report will be reviewed and the investment becomes effective, in general, two

weeks after the acceptance of the report. In certain cases, however, the investors may be required to change the conditions of investment or suspend such investments based on the recommendation made by the Committee on Foreign Exchange and other transactions. Investments in aircraft, arms or ammunition, atomic energy, aerospace development and narcotic industries, etc., are virtually prohibited for reasons of national safety and public order. Investment in primary industries relating to agriculture, foresty, fisheries, mining, petroleum, leather or leather products manufacturing are still limited according to current conditions of such industries. Furthermore, limited numbers of listed companies are still subject to specific review by competent ministries if ownership of such companies by foreign investors as a whole is expected to exceed certain percentages.

A license is needed for the commencement of banking, insurance, securities, gas or electricity and water supply, and broadcasting enterprises, among others, under laws which are equally applicable to businesses wholly owned by domestic investors.

Technical license agreements are also subject to an advance reporting procedure and generally are made automatically except for those agreements relating to certain regulated industries.

EXCHANGE CONTROL:

Under the present law, even though the authorized foreign exchange banking system plays an important role in this area, foreign currency transactions are, in general, free.

An advance report to the Bank of Japan is required for almost all foreign currency loans.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Any remittances of proceeds or repatriations of original investments are not restricted if the obligation to obtain permission or approval or to submit an advance report on the investments has been fulfilled.

EMPLOYMENT RESTRICTIONS:

No work permit is needed in addition to entry visas. Foreign national may work in accordance with visa status and conditions attached to the visa. There would be no legal restrictions or discriminations with respect to emploment of foreign nationals so long as they bear proper entry visas. Visa application may be a time-consuming process in some instances. An exception to this general rule is for hiring foreign nationals as government officials.

LOCAL MATERIAL CONTENT REQUIREMENTS:

No exceptional requirements.

OTHER RESTRICTIONS:

Nothing exceptional noted.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

There is no system of tax holiday. No particular incentives applicable to foreign investment are available.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: KENYA

INTRODUCTION:

Kenya has a free enterprise economy with state intervention being limited to semi-autonomous agencies that generally hold minority industrial shares, promote services and infrastructure, and serve as marketing, administrative and advisory boards.

Kenya's policy is to encourage foreign entities to set up local manufacturing operations, and there are at present no legal limitations on the percentage of foreign ownership. This policy is part of an overall effort to industrialize Kenya and reduce its reliance on agriculture and provide employment for its nationals.

Kenya is encouraging reinvestment of profits locally to reduce the outflow of foreign exchange as the costs of imported energy, industrial and agricultural raw materials and capital equipment continue to rise with an inadequate compensating rise in the volume or price of exports. Consequently, strict exchange and repatriation controls are imposed to limit the outflow of capital and profits. The restrictions vary with the country's balance of payments situation. At present, due to a deficit position and because of increasing fuel costs, controls are rigidly applied.

These policies have been in effect since Kenya achieved its independence in 1963. It is anticipated that it will be some years before the country has achieved a high enough level of industrialization to enable a significant degree of nationalization to occur. However, the government encourages local

participation in new investments, particularly those which are labor intensive. In certain cases, usually where the government considers there to be sufficient local expertise or for reasons of national security, approval will not be given to new investment unless there is an acceptable level of local participation.

There are no countries for which exchange and remittance restrictions are waived.

OWNERSHIP RESTRICTIONS:

There is generally a liberal approach by the government regarding both investment and land ownership. Generally the government will not allow new foreign investment where it will compete with adequate (potential) local investment (for example in areas such as tourism, agriculture and distributive trades), or where the industry or service (for example utilities, radio stations, basic transport) is of importance to the security of the country.

Foreign ownership of agricultural land is not encouraged and requires the approval of the government.

Technology agreements are subject to government appraisal of necessity of services to be rendered or availability of local technology.

EXCHANGE CONTROLS:

The Central Bank is responsible for exchange controls and administers them through its Exchange Control Department. Operations in foreign currency may be effected only through banks authorized to deal in exchange and in compliance with exchange control regulations.

Prior approval of the Central Bank of Kenya is required for all foreign currency loans and any inward foreign investments.

No inter-company accounts may be operated without Central Bank approval.

No airfares for international flights may be paid for in local currency without Central Bank approval. Certain fees are payable for applications to the Central Bank.

REPATRIATION OR REMITTANCE RESTRICTIONS:

No inward investment can be introduced until the approval of the Central Bank has been obtained, as repatriation rights both as to capital and income might be lost.

Technology and all other agreements having remittance requirements must be approved by the Central Bank.

Foreign investment for certain approved industries and operational functions can be acknowledged by the issue of a Certificate of Approved Enterprise under the Foreign Investments Protection Act, which ensures repatriation rights of the original capital, dividends and/or interest.

Generally after tax profits, excluding profits of a capital nature, may be remitted only on equity capital brought into Kenya. After tax there is a withholding tax on dividend remittances. The previous restriction to the quantum of any dividend has now been removed. Branch profits are remittable in the same way as corporate profits, as branches are treated as corporate bodies for exchange control purposes, but are not

subject to any withholding tax. A capital gain arising from the disposal or appreciation of a foreign investor's interest cannot normally be repatriated.

Interest on approved loans, which can be acknowledged in foreign currency, may be repatriated subject to a deduction of withholding tax. The interest rate must be approved by the Central Bank, will normally be stipulated on the Certificate of Approved Enterprise, and may be negotiated at a rate similar to that paid in the source country.

Repatriation of royalties and service fees is subject to the approval of an agreement by the Central Bank, and withholding tax is deductible.

The withholding tax rates from January 1, 1981 are as follows:

Dividends	20%
Interest	20%
Royalties and service fees	30%

Where double taxation agreements exist between Kenya and the recipient country of residence, these rates are reduced.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for all foreign personnel hired on either a permanent or a temporary basis. Work permits are usually issued only where the government considers that the expertise is not available locally. A condition that is sometimes attached to the granting of a work permit is that a local employee is identified as being trained to take over from the foreign personnel within a specified period of time. In

practical terms only the key personnel (for example, General Manager, Technical Manager and Financial Controller) of foreign entities tend to be foreign personnel.

There are no restrictions on their remuneration, but for those residing for ten years or less the remittability of their local earnings is restricted to the equivalent of Kenya Shillings 4,000.00 per month. After ten years remittances are allowable. Other restrictions regarding repatriation of capital apply with certain maximums specified. Restrictions on educational fees also apply to certain categories of expatriate personnel.

LOCAL MATERIAL CONTENT REQUIREMENTS:

The government will usually not issue import licenses for any materials that it determines can be obtained locally, unless the local industry producing the materials confirms that it cannot satisfy the quantities or qualities demanded. Conversely, local industries (including foreign investments) are in some instances protected from imports by the utilization of customs tariffs and sales taxes.

OTHER RESTRICTIONS:

The government controls, by a Price Control Act, the prices of the products of certain industries whether foreign or locally controlled. Examples of products subjected to this control are petroleum products, basic foodstuffs, beverages and tobaccos, cement and detergents. A lead time between cost increases and authorized price increases has had detrimental effects on certain industries.

The government has a tariff for import duties on capital goods and raw materials. All imports are subject to the licensing policy of the government, which is controlled by the Department of Trade and Supplies and the Central Bank; and commodities are now categorized into essential imports, non essential, etc.

All applications for the importation of used plant or machinery must be approved by the Central Bank; at present, difficulties occur in obtaining consent.

All importations are subject to surveillance by General Superintendence for fairness of price and quality.

Quota systems have been introduced by value for certain industries (e.g., private vehicles).

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

In certain instances industrial projects have been exempt from customs duty and sales tax on the importation of plant and machinery.

There have been exceptional exemptions from duty on certain imported goods utilized to manufacture both for locally and foreign controlled companies.

Tax exemptions have been given on certain aid programs, and there are certain government to government exemptions or concessions.

Generally any incentives are the exception rather than the rule.

Other than export rebates, which apply to local and foreign investors, based on the sale prices received in Kenya, there are no subsidies for investors.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: KOREA

INTRODUCTION:

Korea actively encourages foreign entities to set up local manufacturing operations. In particular, the Korean Government released a new set of guidelines for direct foreign investment on July 28, 1981.

Under the new guidelines, direct foreign investment is allowed in 427 industries, or roughly 50 percent of all the nation's industries identified by the Korean Standard Industrial Classification System. Of these, 320 are in the manufacturing sector, and the rest are in such industries as agriculture, mining, hotels, transportation, warehousing and insurance.

OWNERSHIP RESTRICTIONS:

For the purpose of determining the maximum equity share allowed to the foreign investor, the guidelines of the Economic Planning Board (EPB) provide two industrial categories. A foreign equity share of up to 100 percent is permitted in 56 industries falling under Category I, while a foreign equity share of up to 50 percent is allowed in 371 industries falling under Category II.

The Minister of Economic Planning Board (EPB) is, however, empowered to approve a foreign equity share of up to 100 percent even in the industries falling under Category II on the merit of individual investment projects.

Also, the Minister of EPB is authorized to approve projects which are not specifically covered by the guidelines, if such projects are deemed necessary in terms of the development of the national economy, the social welfare, and the strengthening of Korea's international competitiveness.

At present, all foreign investment in Korea is subject to approval of the Korea Government; however, it is the plan of the Government at some future date to shift to a so-called negative system whereby all applications for investment in all eligible industries will receive automatic approval.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through foreign exchange banks obtaining a license to do foreign exchange business from the Ministry of Finance.

All foreign currency loans require prior approval of the Korean Government under the Foreign Exchange Control Law or the Foreign Capital Inducement Act.

REPATRIATION OF REMITTANCE RESTRICTIONS:

Where a foreign investment is made under the Foreign Capital Inducement Act (FCIA), the remittance of profits without limitation is guaranteed. Repatriation of the original investment is also guaranteed by the FCIA.

If a foreign investment is not made in accordance with the FCIA, remittance of dividends and branch profits is regulated by the Foreign Exchange Control Law (FECL), and the repatriation of investment is subject to the permission of the Central Bank of Korea.

Any new investment or capital increase must be approved by EPB.

Reinvestment of profits derived from the original investment is also allowed by FCIA. The reinvestment of profits may be accomplished by reporting to the EPB and requesting confirmation by EPB until the reinvestment of profits is up to the original amount. In cases where the reinvestment of profits exceeds the original investment, such an investment must be approved by EPB.

Loans and technological agreements must be approved by the Government under the FCIA or FECL to ensure remittance rights.

Branches of foreign entities should be registered with the Central Bank of Korea as profit remittance oriented entities in order to ensure the remittance of profits derived in Korea and the repatriation of funds brought into Korea.

When the branch intends to remit its profits or repatriate its invested funds, the amount of remittance and repatriation must be approved by the Central Bank of Korea.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on a permanent or temporary basis.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Pursuant to the FCIA, income taxes on foreign invested companies are exempted or reduced in proportion to the percentage of stocks or shares which foreign investors own. Foreign invested companies are exempted from income taxes for 5 years, and these taxes are reduced by 50 percent for the next 3 years.

Foreign investors are exempted for 5 years from withholding tax on dividends received from foreign invested companies, and their taxes are reduced by 50 percent for the next 3 years in accordance with the FCIA.

Foreign invested companies are exempted from acquisition and property taxes pursuant to the FCIA.

Capital goods imported by a foreign investor under an import authorization for capitalization are exempted from import duties, including customs duties.

Payments to the supplier of technology under a technology inducement contract approved under the FCIA are exempted from income taxes for 5 years and are reduced by 50 percent for the ensuing three years.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: KUWAIT

INTRODUCTION:

Kuwait is a major capital exporting country and as such presents relatively limited opportunities for inward investment. In general, control of any enterprise is restricted to Kuwaitis only, with a maximum of 49 percent foreign ownership. This is generally further restricted to areas requiring new technology or specialized expertise which can be supplied only by an investor from outside Kuwait. Local industrialization is still continuing, but benefits are likely to accrue mostly to companies owned by Kuwaiti nationals.

OWNERSHIP RESTRICTIONS:

All foreign investment requires approval by the appropriate Government department. Even with such approval, Kuwaiti nationals must own at least 51 percent of the capital, with the exception of banks, where no foreign participation is allowed. Land can be owned only by Kuwaiti nationals. There are no other specific industry restrictions other than the general requirement for businesses to be controlled by Kuwaiti nationals. In general only businesses which cannot be handled by existing Kuwaiti companies would be allowed foreign participation.

EXCHANGE CONTROLS:

There are no exchange control regulations in Kuwait. The only exception is dealing in Israeli and South African currencies.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no restrictions on the repatriation of profits or other remittances out of the country, with the exception of dealings with Israel and South Africa.

EMPLOYMENT RESTRICTIONS:

Work permits are required for all foreign nationals (and entry visas for most) working in Kuwait on either a permanent or temporary basis. There is however no particular restriction on the nationals from any one country being employed, although in practice Arab nationals tend to be preferred.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no known requirements for production to include a certain local content. However there are preferences given by way of duty free imports from certain countries with which Kuwait has trading agreements.

OTHER RESTRICTIONS:

There is a general embargo on any companies which have dealings with Israel and who are named by the Israel Boycott Office.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Such investment incentives as exist are not directed specifically to foreign investment, but relate to all new investment. Incentives include loans to manufacturing businesses at low interest rates, the granting of free land by the municipality to approved manufacturing businesses in certain specified areas, tax holidays granted at the discretion of the Ministry of Commerce, and the waiving of duty on certain imported machinery and inventories.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: LIBERIA

INTRODUCTION:

Liberia actively seeks and encourages foreign investment in all economic sectors. Foreign capital is courted irrespective of origin. The desire to attract foreign investment is an outgrowth of the Government's desire to improve the standard of living of its citizens. Liberia accepts the free enterprise philosophy, and given that low domestic savings limit investment capital availability, it is generally recognized that economic development can be pursued effectively only with foreign capital and know-how.

OWNERSHIP RESTRICTIONS:

With minor exceptions, there are no legal ownership restrictions. These exceptions concern the fishing and, to some extent the transport industries. A license is required to fish in Liberian waters. The entity applying for such a license must be 51 percent owned by Liberian nationals - natural or juridical. The majority ownership requirement is essential for the license to fish, as well as for Liberian maritime requirements.

EXCHANGE CONTROLS

No exchange controls.

The United States dollar, which is legal tender, circulates at par with the Liberian dollar. The Liberian dollar is issued in coins of 5 cents, 10 cents, 25 cents, 50 cents and $1 only. There are no Liberian notes.

The National (Central) Bank of Liberia has introduced certain additional charges on the outward transfer of funds since 1980. This increase in charges has become necessary, as the banking system has suffered substantial capital flight following the April 1980 military takeover. The country's external balances during the last few years have been insufficient to finance imports. Regardless of these liquidity problems, operations in foreign currencies continue to be unrestricted.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no legal restrictions on repatriations and remittances.

Under its Open Door Policy, first enunciated in 1944, and reaffirmed by successive Governments, Liberia allows free and unhindered repatriation of capital and earnings.

EMPLOYMENT RESTRICTIONS:

Since about 1972, the Government of Liberia has sought to implement a Liberianization policy, whose essential element is that Liberian services, goods and citizens are to be accorded

preference. This preference is, however, expressed in generalized terms, in that it respects "competitive pricing", "comparable quality", etc. There are no employment restrictions, however. For certain technical and managerial category personnel, the Government actively encourages employment of expatriates, but requires that employers seriously undertake to train Liberians, both formally and on the job.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no legal material content requirements as such, except when an investor wishes to be given "Union Industry Status". This is a preferred category for goods produced in a member country of the Mano River Union (Guinea, Sierra Leone and Liberia), and intended for sale within the Union. The requirements are those normal to customs unions in respect to "local origin".

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Investment incentives

In general terms, investment incentives are granted to enterprises which:

- Ensure permanent employment of Liberians at all levels;
- Are in the priority sectors of the economy;
- Produce local value added amounting to not less than 25 percent of the value of gross output;
- Leave options open for Liberian participation in equity; and

- Use Liberian raw materials where these are available.

Incentives granted, usually for five years, include:

- Exemptions of up to 90 percent of duty on imported machinery, equipment, raw materials and supplies;

- Profits reinvested in fixed assets are tax exempt. Of the remaining profits, 50 percent of the tax that would be payable is waived;

- Full rebate or refunds of duties, income and excise taxes paid in respect to exported manufactured goods; and

- Other preferential treatments available if applicable.

The above are standard for up to $2 million investments. Investments in excess of $2 million could attract additional incentives, such as increase in tax holidays from 5 years to 7 years.

Industrial Free Zone

The Liberia Industrial Free Zone Authority (LIFZA) was established in 1975 for tax free industrial activities for export. Incentives to foreign investors include:

- Tax free and duty free importation of machinery, equipment, raw materials and supplies;

- Exemption from import and export duties;

- 100 percent exemption from corporate taxes; and

- Assistance in obtaining loans and advances.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: LUXEMBOURG

INTRODUCTION:

Luxembourg actively encourages foreign entities to set up local manufacturing operations in the attempt to diversify its industrial production to maintain employment. Local businesses generally are not favored over those with foreign ownership.

OWNERSHIP RESTRICTIONS:

None.

EXCHANGE CONTROLS:

The "Institute Belgo-Luxembourgeois du Change" (IBLC) exercises control over exchange transactions in the Belgian-Luxembourg Economic Union. Two foreign exchange markets exist:

1. The official market, dealing with operations of a commercial nature. Transactions on this market must be carried through an authorized bank. The rate of exchange on this market is controlled.

2. The free market, which is used for financial transactions, mainly relative to investments and securities. This is easily influenced by the varying scope and importance of the foreign exchange operations passing over it.

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REPATRIATION OR REMITTANCE RESTRICTIONS:

At present, there are no restrictions on the repatriation of capital or earnings. The exchange control merely governs on which foreign exchange market the transfer may be made.

Capital: When a business is sold or liquidated, a non-resident is allowed to tranfer the proceeds of his participation on the conditions laid down by the transfer guarantee, or if no guarantee was obtained over the free market.

Loans: If a loan has been made from abroad, the capital repayments are transferable on the conditions laid down by the transfer guarantee, if granted.

Dividends: Dividends paid on Luxembourg shares are transferable to non-residents in the currency of their country. However, for the conversion of official or free market rates, the conditions laid down in the transfer guarantee will apply.

Interest: Interest payments on loans made from abroad are transferable on the conditions laid down by the transfer guarantee of the loan.

EMPLOYMENT RESTRICTIONS:

Citizens of non-EEC countries must obtain a residence permit after three months and a work permit, whereas nationals of other

EEC countries need a "carte de séjour," which is valid for five years. Directors of foreign nationality who come to take up managerial functions in Luxembourg require the authorization of the Minister of National Economy.

Carte de séjour and work permits are generally renewed without difficulty, except under certain conditions where the applicant has been drawing unemployment benefits for more than a year.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

- Own funds can be obtained through an unconditional capital subsidy from public resources or, if preferred, through minority capital participation by the National Credit and Investment Company.
- Long term capital can be borrowed in the form of Government of Community loans at reduced interest rates.
- Loans obtained from credit institutions can, in part, be underwritten by a State guarantee.
- Land for industrial purposes, factory sites and premises are made available by the various local authorities and Government agencies.
- Organization studies are promoted by means of State subsidies as development incentives.

- The cost of workers' training or re-training can be met wholly or in part from State subsidies.

- During the first financial years, enterprises can benefit from substantial income tax reductions.

- In addition, the cost of investment in machinery, equipment and premises attracts tax relief which, in the case of new installations, rises up to 14 precent.

The above concessions are negotiable with the Ministry of Finance.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: MALAWI

INTRODUCTION:

Malawi very strongly encourages inward foreign investment. While investors are strongly encouraged to enter into a joint venture with a local partner (preferably a Parastatal, i.e. state-associated company), this is not mandatory. Any local partner will buy his stake in a conventional manner. Foreign controlled companies cannot operate in the retail sector outside the principal cities or in transport contracting internally. Investment from Arab or Marxist countries is not permitted. There is no official preference for local businesses, but as in any country, patriotism is a factor, and the local business may be favored to a marginal extent because it may be part of an integrated group in a position to offer price competitiveness not otherwise available.

OWNERSHIP RESTRICTIONS:

The only formal restrictions are set forth above, but licensing difficulties would be likely in the infrastructure and communications sector, or for a majority interest in a financing or direct insurance company. A very good case would be needed to obtain consent for acquisition of rural land, but it is not totally impossible.

EXCHANGE CONTROLS:

Borrowing by foreign investors locally requires prior approval and is limited by ratios of foreign investment which vary from industry to industry.

In the case of royalties and technical service agreements, the agreement under which the amounts become payable must be cleared by the Exchange Control authorities before it can be legally entered into. This approval is not readily given, especially where a group relationship exists. Once approval is obtained, however, remittances will be automatic for the period covered by the agreement.

Loan repayments will be permitted, provided the loan agreement has been cleared with Exchange Control before it is entered into. (This is required by law in any event.)

Commitments leading to trade debts require prior Exchange Control approval. This applies to all orders of goods and services from abroad, including orders on behalf of official bodies. Nonessential items are not permitted. Exporters of goods or services to Malawi should ensure that requirements have been met, particularly in the case of emergency transactions. Settlement of foreign trade debts can only be made on production of documentary evidence of the arrival of goods or services in Malawi and must be made within 180 days of such arrival (failing which, the Exchange Control authorities must be informed of the existence of a foreign loan and the manner in which it is intended to be repaid).

REPATRIATION OR REMITTANCE:

Foreign direct investment is strongly encouraged; however, registration with the monetary authorities is essential if dividends are to be remitted abroad.

Remittence of dividends up to the amount of the after-tax profits of a company earned in its most recent financial year will normally receive Exchange Control approval without difficulty, provided the entity has no local borrowings and has permanent capital and long-term loans at least equal to its investment in fixed assets. Special application is required to remit dividends out of earnings of prior periods. Approval is not normally granted except following the cessation of a business, although conversion into external share capital is permitted. The remittance of other forms of profits follows the same formula as for dividends, but in these cases delays frequently occur, since it is necessary to produce proof that all income tax liabilities related to the earnings in question have been settled.

There are no restrictions on the remittance of interest, provided it is at a rate that reflects the prevailing rates in the currency concerned. For a remittance to a country with which Malawi does not have a double taxation agreement, a tax clearance certificate will be required. In the case of a first remittance, the related loan agreement has to be made available for inspection.

Any repatriation of capital from Malawi requires a special application, which will be subjected to protracted examination. The granting of permission in this instance is purely on a discretionary basis but, in practice, the authorities have always gone out of their way to approve such applications in order not

to discourage future investment in the country. Repayment would usually be spread over a period of three to five years, but is subject to negotiation in every case.

Payment for exports of goods or services from Malawi must be repatriated within 180 days unless special permission is obtained. Settlement of trade or other accounts by offset is not permitted.

Provided they have properly registered contracts of employment, expatriates temporarily resident in Malawi can remit up to two-thirds of monthly net earnings and the whole of any bonuses or end-of-contract benefits.

A 5 percent tax surcharge on branch profits and foreign dividends occasionally applies. Where there is no double tax treaty, interest and royalties are payable net of income tax at the standard 45 percent rate.

EMPLOYMENT RESTRICTIONS:

Citizens or residents of Arab or non-African Marxist countries are unlikely to obtain even transit visas. Holders of Commonwealth, EEC, USA, Scandinavian and South African passports do not require visas for business visits up to 90 days.

Work permits are required for all non-nationals (except long-term Commonwealth residents) taking up employment of any kind. No particular ratios apply, but every application is subject to protracted scrutiny by a number of government departments and positive security screening in countries of birth and residence. This takes between 90 days and a year, sometimes longer. Nobody who has previously emigrated formally can subsequently obtain a

work permit. Spouses need a separate permit before seeking work, and a permit holder's adult children are subject to normal visa requirements. Few companies employ more than a handful of expatriates, except contractors working under worldwide tender engagements financed externally.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no specific restrictions except a present temporary requirement to justify any imports to the Central Bank and very heavy tariff protection for locally established industries (including those which are foreign controlled).

OTHER RESTRICTIONS:

All manufacturers are subject to price control, which is not unreasonable but sometimes moves very, very slowly. Minimum wage levels exist, but these are extremely low. Foreign controlled companies need permission to borrow locally, and this is sparingly granted unless directly connected with exports. A number of crops have to be sold to a state marketing authority, although a large scale operation may seek permission to export directly. There is no element of discrimination in this.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

As a matter of policy, there are no subsidies in Malawi.

Generous tariff protection is available to new industries; tariffs on raw material and capital goods are low; and there is a duty draw-back scheme on re-exports.

Generous investment and depreciation allowances, and allowances for pre-operating costs, land clearing and establishment of long term crops mean that few non-service companies pay taxes in their early years, although there is no formal tax holiday system.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: MALAYSIA

INTRODUCTION:

Malaysia welcomes foreign investment as part of an overall plan towards industrialization to generate employment for its nationals. Investment opportunities abound, and the private sector is expected to contribute 72.2 percent of total targeted investments, i.e. M$74,111 million under the Fourth Malaysia Plan (1981 - 1985).

However, Malaysia also realizes its lack of technical know-how and therefore encourages joint ventures with nationals to develop the country's resources as well as to achieve some measure of economic and technological self-sufficiency. The New Economic Policy (NEP) adopted in 1970 aims at increasing Malaysian participation in the expanison of total equity capital over the period 1970 to 1990, so that by 1990 ownership of equity capital will include at least 30 percent Bumiputra (Malays and other indigenous races) and 40 percent other Malaysians. Guidelines pertaining to equity structure and employment were introduced to ensure that where possible nationals are involved in all business ventures. Businesses with a local majority, particularly indigenous interests, are given priority in competition for government contracts. While businesses are encouraged to reinvest their profits, there are no restrictions on capital repatriation and exchange control regulations are quite liberal.

OWNERSHIP RESTRICTIONS:

Foreign ownership in the corporate sector is restricted by the following guidelines:

- Industrial projects which are dependent to a large extent on the domestic market are expected to have at least 51 percent Malaysian, including 30 percent Bumiputra, participation;
- Projects utilizing important non-renewable resources, particularly at extractive and primary processing levels, are expected to have at least 70 percent Malaysian, including 30 percent Bumiputra, participation.

Ownership of primary petroleum resources is by law vested in the government-owned petroleum company, Petronas.

Private ownerhip of railway transportation, airlines and public utilities is restricted.

Technology, joint venture, management and technical assistance agreements come under the perview of either the Foreign Investment Committee or the Ministry of Trade and Industry. Appraisal is made of the necessity of the service as well as terms and conditions and royalty/technical fees to ensure that Malaysians are given a "fair deal".

Foreign acquisition of assets exceeding $1 million in value or the equivalent of 15 percent or more of voting power requires the prior approval of the Foreign Investment Committee.

EXCHANGE CONTROLS:

All financial dealings with residents and currencies of Israel and South Africa may be effected only with the specific authorization of the Controller of Foreign Exchange.

Borrowings from non-residents which exceed M$1,000,000 require the approval of the Controller of Foreign Exchange.

Foreign controlled companies may borrow up to M$500,000 from local banks and financial institutions. All other local borrowings require approval.

Foreign takeover of a Malaysian company will require approval of the Controller of Foreign Exchange.

A traveller may not bring into the country more than M$10,000 and may not take out more than M$5,000 in currency notes.

Import of treasury bills requires approval.

External accounts may not be overdrawn in excess of M$100,000 without approval.

Export of gold bullion in the form of bars and wafers weighing more than 100 grams is restricted.

Exports worth more than M$5,000 f.o.b. per shipment require approval.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Remittances exceeding M$2 million require the approval of the Controller of Foreign Exchange.

Authorized banks are required to cite the letter of approval for loans exceeding the permitted limit before approving repayments.

EMPLOYMENT RESTRICTIONS:

All foreign personnel are required to obtain work permits which are issued only if local expertise is unavailable and are subject to the following guidelines:

- Expatriates in executive positions which require professional qualifications and practial experience may only be employed for a maximum of ten years;
- Expatriates in non-executive positions which require technical skills and experience cannot be employed for more than five years; and
- Companies with foreign capital participation of more than $500,000 are allowed one or two key posts (i.e. posts which can be held indefinitely by non-nationals).

The employment of nationals at all levels should, wherever possible, reflect the ethnic composition of the country, which is 50 percent Bumiputras (Malays), 35 percent Chinese and 15 percent Indian and other minority groups.

LOCAL MATERIAL CONTENT REQUIREMENTS:

The policy introduced in the vehicles assembling industry was based on varying lists of products to be omitted from imported c.k.d. (completely-knocked-down) packages. Additional standard

items are tires, cables and wires, nuts and bolts, metal sheet covers and paints.

Imported motors may not be incorporated into locally produced agricultural processing machinery for the domestic market.

Motorcycle assemblers will be required to use up to 60 percent locally made components in their machines by 1985.

To be eligible for duty exemption, assemblers of power tillers are required to include a minimum of 5 percent locally made components by their third year of operation, with annual increases based on a list of components drawn up by the Malaysian Industrial Development Authority.

OTHER RESTRICTIONS:

A selective prohibition of imports is imposed from time to time as a protective measure to support fledgling industries.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Companies establishing manufacturing operations which are of economic significance or export-oriented industries are eligible for "pioneer status", which provides a tax holiday ranging from two years to a maximum of eight years depending on capital investment and other conditions.

In addition, qualifying capital expenditure incurred during the tax holiday period may be carried forward and treated as capital expenditure incurred after the tax relief period.

Companies not eligible for pioneer status may obtain the same relief benefits based on the number of full-time paid employees.

An approved company locating its factory in an area specified by the government as a locational incentive area may be granted a maximum tax holiday of up to ten years based on the level of fixed capital expenditure and employment.

Companies not eligible for a tax holiday may be granted investment tax credits of not less than 25 percent for a period of not more than five years.

The 40 percent corporate tax rate can be reduced to 35 percent for income derived in 1979, 1980 and 1981 where the company has a net worth in excess of M$1 million, provided that it complies with the full objectives of the local participation rules of the New Economic Policy.

Accelerated Depreciation - 100 percent first year depreciation is allowed as a temporary incentive for expenditure incurred during the first five years of operations.

Three kinds of export tax incentives are available:

- An export allowance equivalent to 2 percent of exports plus 10 percent of the year's export increase;
- Double deduction for expenditure incurred in certain export promotion activities; and
- Accelerated depreciation allowance.

Other incentives include:

- Exemption of import duty on imported plant and machinery;

- o Loan and export refinancing facilities; and
- o Availability of free trade zones.

A Malaysian product which incorporates at least 50 percent by value of Malaysian raw materials and for parts and components manufactured in Malaysia can qualify for additional incentives. "Malaysian content" excludes wages, salaries and other domestic input.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: MALTA

INTRODUCTION:

Malta actively encourages foreign entities to set up local manufacturing operations. This policy is part of an overall effort to industrialize Malta and to provide employment for its nationals. Malta also tries to induce the reinvestment of profits in the country by granting certain tax advantages. Although there are normal exchange control regulations, the repatriation of capital and profits is not impeded to any marked degree. These policies have been in force for some years.

It is not anticipated that nationalization will become a feature of government policy in the near future. Nor is it anticipated that the Government will tend to drive out the foreign entrepeneur. Indeed, Government has entered into joint ventures with foreign interests.

Policy in the award of Government contracts is not made public, but it is understood that preference is given to local businesses where these can compete with foreign rivals at the same level.

OWNERSHIP RESTRICTIONS:

Restrictions on foreign ownership are limited to those sectors which are of fundamental importance to the local economy. This policy has not, however, excluded foreign minority participation in the National Shipping Line or in the three local commercial banks. Government policy is aimed at encouraging joint ventures where local investors participate in various degrees with foreign

investors, but 100 per cent foreign owned investments are also encouraged, particularly in the light engineering field.

There is no restriction on the foreign ownership of newspapers. From time to time there have been local newspapers wholly, or almost wholly, foreign owned, while at any given time there is always some foreign interest in local newspapers. The state maintains a monopoly on television and radio stations, while coastal shipping is of no importance in Malta.

The acquisition of real property by non-residents of Malta is strictly regulated. While permission to acquire a dwelling house is readily given (and is in fact a condition attached to certain residency permits), the acquisition of other property is very rarely allowed.

Technology agreements are subject to appraisal by the Central Bank. Because of Malta's status as a developing country, this scrutiny tends to concentrate on evaluation from exchange control and taxation viewpoints, apart from the accruing benefit to the Maltese economy.

<u>EXCHANGE CONTROLS:</u>

Operations in foreign currency may be effected only through banks authorized to deal in exchange and other authorized dealers. Prior approval of the Central Bank of Malta is required for all foreign currency capital. Malta registered corporations having more than twenty per cent of their capital directly or indirectly foreign owned cannot borrow without prior Central Bank approval. Property acquired by infringement of the Exchange Control Act may have to be sold in the manner directed by the financial authorities. Any person who commits an offence against the said

Act is liable on conviction to a fine of not more than two thousand Malta pounds (M2,000) or to imprisonment for a period of not more than two years, or both. Where, moreover, the offense is concerned with currency and any other property, and does not consist only of a failure to give information or to produce documents as required under the Act, a larger fine may be imposed not exceeding three times the value of the currency or other property involved. The Court may also order forfeiture of the currency or other property.

REPATRIATION OR REMITTANCE RESTRICTIONS:

All investment in Malta must be registered with the authorities to ensure repatriation rights. This is automatic, since such investment is, in any case, subject to exchange controls. The same situation holds in the case of capital, loans and technology agreements. New investments and capital increases cannot be effected without prior Central Bank approval being given to the Registrar of Partnerships. Profits can be remitted when made on capital brought into Malta, or on reinvestment of profits derived from such capital. As a general rule, there should be no difficulty in obtaining approval for this remittance. However, the Central Bank expects to see the most recent trading figures before final approval is given for repatriation of profits.

There are no supplementary taxes chargeable on the remittance of profits. Certain tax advantages otherwise obtainable on reinvestment are lost, but other advantages may be obtainable under the double taxation agreements. The repatriation of capital in excess of the amount originally registered in foreign currency with the Central Bank is subject to close scrutiny and requires special approval. There is, however, no capital gains tax as such, nor are any withholding taxes chargeable thereon.

There are no tax restraints on the remittance of dividends or branch profits on registered foreign investments. The person who makes payment of such income is, however, required to deduct therefrom the appropriate rate of tax. These deductions are not withholding taxes but effectively only prepayments of the tax eventually payable on the income. The correct amount of tax is later adjusted following the submission of tax returns.

There are no restrictions on the payment of royalties by a Malta subsidiary to a foreign parent, provided the payment is made on an arms-length basis. Deductions of tax at source in the form of prepayments of the eventual tax due are, however, also required as in the case of dividends and branch profits.

The remittance of service fees is subject to verification that the services are effectively rendered.

EMPLOYMENT RESTRICTIONS:

The engagement of foreign personnel is subject to work permits. Where the relative work is likely to be of a permanent nature, it is a condition that a local understudy be given the necessary training to be able to take over in due course. Permits, whether on a short term or a long term basis, are only issued where the necessary skills or knowledge is not available in Malta. In practice applications for work permits are seldom refused. There are no rules regarding the proportion of total remuneration. Few enterprises employ substantial numbers of expatriates. There are no rules regarding the procedure to be followed in layoffs, but as foreign employees are usually those possessing special skills, they would normally be among the last to be laid off.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Malta produces few component parts for machinery, and there are no restrictions on the importation of such goods, which are, however, subject to an import license.

OTHER RESTRICTIONS:

There are no other restrictions on foreign investment which, as stated in the Introduction, is actively encouraged in Malta.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

Investment incentives in Malta are covered by the Aids to Industries Ordinance. In addition to taxation concessions, the Ordinance allows the duty free importation of all plant and machinery and raw materials which are both, however, subject to an import license. It also authorizes the imposition of anti-dumping and countervailing duties.

The incentives program is directed by the Malta Development Corporation, which is a public corporation set up by Act of Parliament. The Malta Development Corporation also controls the distribution at very advantageous terms of Government built factories in nine fully serviced industrial estates.

Saving tax concessions, there are few financial incentives offered to entrepreneurs, though subsidized utility costs may be of some importance.

The normal tax structure of the country is in itself an incentive. Such features as the indefinite carry forward of losses, the single tier taxation of corporate profits and the

taxation of foreign employees on the basis of domicile and ordinary residence, offer attractive incentives.

Particular tax incentives offered under the Aids to Industries Ordinance, which makes very few and only relatively unimportant distinctions between foreign and local industries, are the following:

- Tax holidays of up to ten years, with the possibility of distributing tax free profits in the form of tax free dividends. It should be noted, however, that this concession has not been granted for some time.

- An investment allowance grants an additional 20 per cent depreciation, so that over an asset's working life the total deductions granted represent 120 per cent of cost price.

- Accelerated depreciation (incorporating the investment allowance as above) enables the depreciation of assets at the following rates:

1st year	50%
2nd year	20%
3rd year	20%
4th year	10%
5th year	10%
6th year	10%

- Reduced rates of tax are available where profits are re-invested to increase exports or for the purpose of import substitution. The reduction of tax granted under this provision is as follows:

Proportion of income set aside	Reduction in corporate rate of 32.5%	Net Rate payable
60% or more	17.5%	15%
40% - 60%	12.5%	20%
30% - 40%	7.5%	25%
0% - 30%	-	32.5%

Apart from the Aids to Industries Ordinance, the main provision granting tax exemptions is the Merchant Shipping Act, which grants important tax benefits to ships of not less than one thousand net tons registered in Malta and owned by Maltese companies. This concession must however be viewed in conjunction with certain restrictions contained in the double tax treaties on its account.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: MEXICO

INTRODUCTION:

In general, the attitude of recent administrations in Mexico has been to accept investments of foreign capital, except in certain fields reserved for Mexican nationals as mentioned below, particularly when new skills or manufacturing techniques are introduced and the foreign investment also helps to maintain the exchange rate of the Mexican Peso. The current Administration has indicated its recognition of the need for substantial private capital investments, both foreign and local, to provide additional employment opportunities and to increase industrial production in Mexico. However, the government wishes to avoid having important decisions regarding business operations in Mexico being made in foreign countries. Accordingly, under a law which became effective in May 1973, new direct foreign investment is authorized up to a maximum of 49 percent of the capital stock of a Mexican company; and the acquisition, by foreigners, of more than 25 percent of the capital stock or 49 percent of the fixed assets of a Mexican company and requires prior authorization of the National Commission on Foreign Investment.

Certain restrictions also exist on the expansion of existing foreign controlled companies.

It has long been a government policy not to accord the foreign investor any more favorable treatment under Mexican law than that accorded to domestic investors. Many tax and other incentives are not available to companies which are not controlled by

Mexican nationals. However, there are no direct controls or restrictions on foreign exchange transactions or remittances of foreign currency.

OWNERSHIP RESTRICTIONS:

The Law for the Promotion of Mexican Investment and Regulation of Foreign Investment was published on March 9, 1973, and codified many of the rules regarding foreign investment which had been previously applied as administrative policies. It also provided a few additional limitations on new investment, and restricted the expansion of existing Mexican companies under majority control by foreigners. Foreign investment is considered to be that realized by foreign individuals or juridical persons, as well as by Mexican enterprises, the majority of whose capital is owned by foreigners, or in which foreigners have the right, for whatever reason, to determine management of the enterprise.

Foreign investment is specifically prohibited for a substantial number of specified economic activities, including certain activities reserved for the Mexican Government, such as petroleum and hydrocarbons, basic petrochemicals, radioactive minerals and the generation of nuclear energy, electricity, railroads, telegraphic and radio communications, as well as certain mining activities as provided for in the mining law. A number of other activities are reserved to Mexicans or to Mexican companies which prohibit ownership of their shares by foreigners. These include radio and television, automotive transportation (whether on urban, interurban or federal highways), airways and national maritime transportation, forestry and distribution of gas.

The restrictions on investments in banking, insurance, bonding and investment companies do not prohibit the minority ownership of shares by individual foreigners not acting as a group.

Ownership of land and waters within sixty-two miles (100 kilometers) from the border and thirty-one miles (50 kilometers) from the coastlines is also prohibited to foreign investors. Foreign companies may not acquire title to land or waters anywhere in the country.

As an exception to the foregoing restrictions, the National Commission on Foreign Investment has authorized 100 percent foreign ownership of in-bond processing companies, except for those in the textile industries, which are usually located close to the U.S. border, and which assemble or process foreign raw materials and components for re-export.

Except for transfers within the same interest group, transfers of shares of the in-bond processing companies and transfers of minor interests of foreign shareholders, all transfers of ownership of the shares of a Mexican company exceeding 25 percent of such shares or when more than 25 percent of such shares is or would become owned by foreigners, require the prior authorization of the National Commission on Foreign Investment, whether the shares to be transferred are owned by foreigners or Mexicans, if the transferee is a foreigner.

A wide range of agreements providing for technical assistance, transfers of technology or the administration of Mexican companies require prior approval and registration by the National Registry of Transfers of Technology. The process of authorization involves acceptance that other technology is not available at a cheaper price, and fees for the technology are strictly

limited, in general, to a maximum of 3 percent of the earnings of the Mexican company which arise from the use of the technology. Contracts for a period of more than ten years are also not accepted.

EXCHANGE CONTROLS:

Mexico has never established control of any sort on transactions in foreign currency, The government-owned central bank, Banco de Mexico, S.A. is responsible for general supervision of the exchange market and for determining the rules which must be followed by Mexican banks in carrying out exchange transactions.

REPATRIATION OR REMITTANCE RESTRICTIONS:

As indicated, there are no direct restrictions on remittances of foreign currency for whatever purpose. Accordingly, there are no provisions for registering direct investments in Mexico made in foreign currency. On the other hand, no guarantees against inconvertibility are offered by the government.

EMPLOYMENT RESTRICTIONS:

Special entry visas and work permits are required for foreign personnel, whether hired on a permanent or temporary basis. Foreigners working for non-resident companies and desiring to carry out technical assistance, professional services or other types of work in Mexico, should also receive working permits and visas from the Mexican Consulates.

The Labor Law provides that at least 90 percent of any company's employees must be Mexican citizens, although top executives may generally be excluded from the calculation of this percentage.

There is no restriction as to remuneration. The immigration of foreigners for managerial or other positions is permitted only if qualified Mexicans are considered to be unavailable, and work permits with the right to receive remuneration from Mexican sources can be quite difficult to obtain.

LOCAL MATERIAL CONTENT REQUIREMENTS:

In line with the government's efforts to promote employment and industrialization, many types of foreign-made industrial raw materials and components require prior import permits. As a means of assuring the issuance of such permits, manufacturing companies often enter agreements with the Ministry of Commerce or National Resources and Industrial Development, providing for an increasing percentage of national content of their products. A goal of 60 to 80 percent national content is usually sought.

A tax rebate on exports of manufactured products is also based on a minimum national content.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

No subsidies or other incentives are offered to foreign investment, although companies having a minority foreign ownership may participate in the incentives offered to industry in general for new or expanded investments in areas outside Mexico City and certain other industrialized areas. There are no restrictions as to ownership of companies for purposes of the tax incentive for the export of manufactured products.

NON-TAX INVESTMENT RESTRICTIONS:

COUNTRY: MOROCCO

INTRODUCTION:

The Moroccan government generally welcomes foreign investment, and the Investment Code of 1973 was designed to stimulate such investment. The Moroccanization Law of that year has, because of its insistence on Moroccan shareholding and control, tended to discourage some potential investors. However, it should be noted that the Moroccanization Law does not apply to all types of business, and the incentives granted by the Investment Code are available in some cases to 100 percent foreign-owned business, notably in the tourism and shipping industries.

The opportunities for foreigners to invest in Morocco are particularly good in sectors where the foreign investor can contribute specialized techniques or skills (for example, engineering consultants or industrialized building) or provide employment for a significant number of local workers, thereby helping to reduce unemployment while benefiting from the relatively low labor costs in Morocco. In the case of many industries, however, such as cement and pharmaceuticals, it should be borne in mind that profitability can be severely restricted by government price controls.

OWNERSHIP RESTRICTIONS:

Depending on the activity of the business, the Moroccanization Law under Dahir No. 1.73.210 of March 2, 1973, requires that Moroccan citizens or Moroccanized companies hold at least 50

percent of the share capital and constitute a majority on the Board of Directors, or that all partners and capital be Moroccan.

Under the law, companies involved in commercial banking, insurance and service activities were required to Moroccanize. Although not required to do so, some companies involved in manufacturing activities have voluntarily Moroccanized by taking on Moroccan partners. Except for exporting enterprises and companies in the tourist industry, new companies formed in Morocco, although not necessarily subject to this law, may find that by Moroccanizing they can take advantage of increased investment incentives.

EXCHANGE CONTROLS:

Purchases and sales of foreign exchange may be carried out only by banks authorized by the Exchange Control authorities, which must account to the Central Bank for all such transactions.

For all new foreign currency investments and loans, a pool of blocked Dirhams (capital accounts) exists which may be purchased by foreign investors at rates of exchange which are usually very advantageous. Only a maximum of 50 percent of the investment can be financed in this manner, and the amount involved may not exceed 25 percent of the capital of the investee company.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Written guarantees, required for the repatriation of capital (in case of liquidation) and transfers of profits and dividends abroad (without limitation) are normally obtained very rapidly.

Repatriation of capital used to acquire blocked Dirhams is not normally permitted within five years of the investment.

Foreign residents holding work permits may remit up to 30 percent of their net of tax monthly salary (or 50 percent if the family of the married foreign resident lives outside Morocco).

EMPLOYMENT RESTRICTIONS:

Work permits are usually granted to foreigners with suitable professional qualifications. Residence permits are issued on production of the work permit.

A work contract binding the employer to each employee is governed by the Royal Decree of August 13, 1973, which lays down a code of obligations and contracts. The work contracts of foreign employees must be approved by the Ministry of Labor.

LOCAL MATERIAL CONTENT REQUIREMENTS:

No particular requirements.

OTHER RESTRICTIONS:

Import restrictions - Prior authorization must be obtained for imports of non-luxury items and manufactured or semi-finished goods necessary to complement local production. The importation of luxury goods and goods of a type manufactured in Morocco is prohibited. With certain exceptions, businesses importing goods are required to deposit with a bank for a period of six months 25 percent of the value of the imported goods. This deposit, which does not bear interest, is a separate transaction from the settlement of the suppliers' invoice.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

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NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: THE NETHERLANDS

INTRODUCTION:

The Netherlands has a favorable attitude toward foreign investment. Foreign enterprises established in the Netherlands have the same rights and obligations as any other Dutch enterprise. Investment incentives are available to domestic and foreign enterprises alike, and under certain circumstances foreign employees assigned to work in the Netherlands are entitled to certain tax benefits.

Labor unions are receptive to foreign investment and management, especially when this leads to improved employment possibilities and related benefits.

The Government views with favor the continued industrialization of the Netherlands through the sole efforts of private enterprise. Thus, domestic restrictions on foreign investment are minimal, although this may be influenced in the future by EEC policies.

OWNERSHIP RESTRICTIONS:

In general, no restriction exists as to foreign ownership of any local enterprise or joint venture.

There is an exception for certain shipping companies without Dutch management, and in addition the Government has reserved the option for up to 70 percent participation in a miner (oil and gas) exploitation company if the exploitation is deemed to be economically feasible.

There are State monopolies in the following areas:

Railroads
Central Bank
Radio and television broadcasting
State printing office
Postal, telephone and telegraph systems

EXCHANGE CONTROLS:

The Netherlands Bank is the central bank responsible for the administration of foreign exchange regulations. The Bank has the power to restrict imports and exports of capital, but at present in most cases it merely requires that transactions be reported to it for statistical purposes so that it may take regulatory action if the need arises. What restrictions there are relate largely to borrowing and lending rather than to movements of equity capital, although administrative procedures must be complied with in all cases.

Foreign exchange licenses are required in the following instances:

- Loans or credits to non-residents for a period of 2 years or longer exceeding Dfl 10 million or the countervalue in another currency per year, unless directly related to a trading transaction.

- Loans or credits from non-residents for domestic purposes exceeding Dfl 500,000 or the countervalue in another currency per year, if the loan is not granted in connection with merchandise transactions or if the loan

is not secured by a mortgage on real estate. (Further restrictions apply to loans exceeding Dfl 16 million).

- The assignment of guilder claims from residents to a non-resident.

- The issue of domestic bonds, notes, mortgage bonds and similar securities to non-residents.

- The sale of Netherlands Treasury paper or guilder bank promissory notes to non-residents.

- The granting of guarantees, pledges or other securities to non-residents unless involving trading transactions.

In general, Dutch residents are obliged to use authorized banks when paying or receiving money from non-residents, irrespective of the currency employed. The intermediary bank must be supplied with data concerning payments and receipts. Special notification requirements are imposed on the following transactions:

- Bank accounts opened or held with non-residents.

- Contracts re purchase or sale of goods to/from non-residents with agreement for payment more than 12 nonths before or after delivery.

- Resident directors or representatives of a Dutch company or a foreign company with a Dutch branch must inform the bank of changes in capital participations in the Dutch or foreign company and also, in the latter case, changes in the Dutch branch "capital", i.e. head office account.

- Notification must be given for transactions with non-residents relating to renewal of a debt, payment of debts, taking up foreign loans to lend to third parties or to pay foreign debts, or taking up a Dutch loan from a non-banking entity by a non-resident in order to pay a debt to a Dutch resident.

REPATRIATION OR REMITTANCE RESTRICTIONS:

In general, no exchange control restrictions exist as to the repatriation of capital and earnings. No obligations exist that would require foreign currency earnings to be placed at the

disposal of a bank or other governmental agency. Related interest and capital repayments on a loan, whether or not made under a required exchange license, are transferable in any currency. Dividends paid on a Dutch company's shares are transferable to non-residents in the currency of their country or in any other currency.

EMPLOYMENT RESTRICTIONS:

Foreign nationals who intend to stay in the Netherlands for longer than three months must obtain an authorization for provisional sojourn from the Dutch embassy or consular respresentative in their home country. If a foreign national intends to work in the Netherlands, he will not receive an authorization for provisional sojourn until the appropriate authorities have proof that a labor permit is being or will be issued.

The above restrictions do not apply to citizens of the EEC countries, the United States, Switzerland and Scandinavia. However, all foreign nationals intending to stay for longer than three months must register with the local police in order to obtain a residence permit, valid usually for one year.

Foreign nationals from non-EEC countries who intend to work in the Netherlands must have a labor permit which is obtained from the District Employment Office by the future employer.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Import licenses are required for:

- o Merchandise of unknown origin or originating from the People's Republic of China, the USSR and other communist countries (Comecon).
- o A number of goods from Japan and Hong Kong.
- o Products subject to agricultural import levies.
- o Products of a dangerous nature.
- o Some chemicals, pharmaceuticals and meat.

Licenses are required for the following services, industries and professions:

- o Medicinal products.
- o Banking and insurance.
- o Road transport, shipping and international air traffic.
- o Accountants, doctors, lawyers, and notaries.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The Government provides various investment incentives.

The Investment Account Law (WIR) provides for a system of tax premiums given for investment in certain buildings and plants. These premiums consist of basic amounts and a series of supplements. In total, they can be as much as 50 percent of cost for industrial buildings and 25 percent for fixed plant. They are offset against tax assessments and do not affect the depreciable cost of the assets concerned. If the WIR premiums exceed the tax liability, the excess is paid in cash. Similarly,

if a company is in a loss position, the full amount of premiums is payable as a cash grant.

If, however, the investment is in the west of the country, the effect of the WIR premiums is reduced by the operation of the Selective Investment Levy (SIR). This may be charged at a rate of up to 13 percent of cost.

Further incentives are granted under the Investment Premium Regulations (IPR) to encourage investment in certain areas outside the western region of the Netherlands. A premium of up to 25 percent (sometimes 15 percent) of capital expenditure on land, new buildings and machinery is available, usually up to a maximum of Dfl 4,000,000. Alternatively, in labor-intensive industries, the investor may choose to take a grant of 15 percent (maximum Dfl 2,400,000) of capital expenditure plus Dfl 12,500 for each new permanent job created, usually up to a combined maximum of Dfl 5,000,000. Certain conditions have to be satisfied before these premiums are granted.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: NETHERLANDS ANTILLES

INTRODUCTION:

The Government is eager to attract manufacturing industries, hotels, and land development companies. In 1953, a law for the Promotion of Industrial Establishments and Hotel Construction was enacted. This law provides tax concessions to new manufacturing industries, land development companies and hotels under certain conditions, which may include ten-year exemptions from corporate profit tax, real estate taxes, occupancy taxes, and exemptions from import duty on raw materials and semi-finished products to be used in production.

OWNERSHIP RESTRICTIONS:

There is no restriction on foreign ownership of enterprises permitted to operate in the Netherlands Antilles.

There are no signs indicating the Government has any intention of increasing its participation in industry in the islands.

EXCHANGE CONTROLS:

The Bank van de Nederlandse Antillen (Central Bank) is responsible for the operation of exchange control. However, the authorized commercial banks are permitted to provide foreign exchange for most currency transactions without prior approval from the Central Bank.

Liberal foreign exchange regulations are a necessity for the economy because of the country's dependence upon international trade and its need for investment in industry to reduce unemployment. In addition to minimizing controls, the linking of the Netherlands Antilles guilder to the U.S. dollar also encourages stability in the flow of foreign investment, as it eliminates the risk of exchange fluctuations for U.S. dollar investors.

Payments and receipts for imports into or exports from the Netherlands Antilles may be made in any convertible currency except Netherlands Antilles guilders. Exchange proceeds have to be surrendered so an export can obtain non-resident status, enabling them to dispose of the proceeds themselves if received from non-residents and not held for or on behalf of residents. Where payments are made through authorized banks, the transactions must be reported to the Exchange Control Committee, but this is for statistical purposes only.

A license is required for the investment of foreign capital; however, this is usually readily obtainable if the investment is in the economic and social interest of the Netherlands Antilles.

There is no requirement for a local corporation to register foreign capital.

REPATRIATION OR REMITTANCE RESTRICTIONS:

A license is required for the repatriation of capital and earnings from the Netherlands Antilles. However, this is normally granted since there are no restrictions on such repatriations.

The convertibility of the Netherlands Antilles guilder is guaranteed by the Government of the Netherlands.

EMPLOYMENT RESTRICTIONS:

An individual who comes to the Netherlands Antilles to engage in business or work must submit an application for a work permit to the Department of Immigration. Netherlands Antilles companies may employ aliens if qualified Antillean individuals are not available. Generally, an application filed by a company must include evidence that the position has been advertised in the Netherlands Antilles without success and that the N.A. Ministry of Labor confirms that no Antilleans are available who are capable performing the duties involved.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Certain import restrictions are imposed to encourage local industry. There are two methods used, as follows:

- Import duties - Competition for certain local products is virtually eliminated by imposing additional duties on imports. For example, a duty of 95 percent is levied on certain paper product imports duties.

- Purchase quotas - Import licenses for some products are conditional upon the purchaser acquiring a certain percentage of his total purchases of that product locally. For example, a battery retailer must purchase at least 67 percent of his batteries locally.

At least one of the above methods is applied to approximately fifteen products on Aruba and Curacao. Restrictions on the other islands are minimal.

For the imports of certain products, notably drugs, special licenses are required, but these are normally granted to

enterprises which have business licenses to deal in these products.

OTHER RESTRICTIONS:

No exceptional restrictions.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The major source of investment incentives is the tax system. However, it is possible in certain circumstances for a company commencing a new production or processing industry in the Netherlands Antilles to be granted a monopoly. Such a monopoly can be granted for a period of 10, or even 25 years. In some instances where a monopoly is not granted, competition may be discouraged by placing additional levies on competitive imports.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: NEW ZEALAND

INTRODUCTION:

New Zealand actively encourages foreign investment in the development of the economy, particularly in projects for energy development and use and in the establishment and expansion of industry with export potential.

Over the years governments have acknowledged the important role overseas investment has played in developing New Zealand's economy, and present government policy recognizes that further significant overseas investment will continue to contribute substantially to New Zealand's future. While exchange control regulations require the prior approval of the Reserve Bank for all remittances from New Zealand, it has always been the practice of the Bank to approve the remittance of interest, profits, and dividends earned in New Zealand to non-resident investors and to approve the repatriation of all non-resident capital, including capital gains.

OWNERSHIP RESTRICTIONS:

The Overseas Investment Act and Regulations provide a mechanism by which new foreign investment can be screened where matters of national interest are involved. Approval is required where 25 percent or more overseas equity participation is proposed. However, the level of equity participation is a relatively minor factor in the assessment of any proposal. Takeover proposals involving either shares or assets where the total consideration is less than $500,000 receive automatic approval unless there is

some special factor involved. New investment proposals are evaluated in the light of the following criteria:

- Introduction of new technology or technical skills;
- Development of new export markets;
- Positive contribution to the country's balance of payments;
- Creation of employment opportunities;
- Competition to local industry; and
- Promotion of economic growth.

The following factors are also taken into account:

- Ownership and control of natural resources, farmland and off-shore islands;
- Ownership and control of certain industries, including communications, the press, and advertising; and
- Impact on the environment.

EXCHANGE CONTROLS:

Exchange control policy covering overseas investment, borrowings, receipts and payments is administered by the Reserve Bank and Overseas Investment Commission. Consent is required for an overseas company (or local subsidiary) to raise funds by the issue of securities or shares in New Zealand. Approval for local borrowings from all sources is required where total local borrowings exceed $300,000. New Zealand incorporated companies must obtain Reserve Bank approval for all overseas borrowings. Remittances from New Zealand require prior approval of the Reserve Bank or, in some cases, a trading (commercial) bank. Generally payments are monitored only to prevent unauthorized

capital transfer. The proceeds from sale of export goods or from services performed in New Zealand for non-residents must be transferred to New Zealand through the banking system.

REPATRIATION OR REMITTANCE RESTRICTIONS:

The prior approval of the Reserve Bank is required before a New Zealand resident may enter into any agreement with an overseas resident to make royalty or similar payments for any form of knowledge, assistance or manufacturing or patent rights.

Remittance of interest, profits, dividends and royalties must also be approved, but this is generally subject only to the provision of satisfactory evidence as to source and beneficial ownership of the amounts to be remitted.

It is the practice of the Reserve Bank to approve the repatriation of all non-resident capital including capital gains and capitalized profits, provided the original investment funds come to New Zealand by way of remittance through the banking system or by some other approved method. Evidence as to the method of transfer of the original capital is usually required.

EMPLOYMENT RESTRICTIONS:

Entry visas, work permits and immigration qualifications apply in most instances where permanent residence is sought. Work permits for temporary employment are considered on their merits.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no specific local content requirements in manufacturing industry, although a system of import licensing regulates the

type and volume of a wide variety of imported goods including components.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The government offers a wide range of income tax and other incentives to both local and overseas businesses to promote export growth and development of the farming and tourism industries.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: NICARAGUA

INTRODUCTION:

The government is currently studying a new foreign investment law which will substantially reform the present outdated law. It is presumed that this law will attempt to encourage foreign entities to set up local agro-industrial operations to utilize the available natural resources of Nicaragua. Due to the present economic and political environment, this policy will be part of an overall effort to industrialize the agricultural sector and to provide employment for the agricultural labor force that represents approximately 80 percent of all available labor.

The government is attempting to induce reinvestment of profits by imposing strict exchange and repatriation controls. A law forbidding the decapitalization of companies operating in Nicaragua was enacted in 1980 and provides serious penalties, including confiscation of assets, for any offenders. It is also expected that as the country achieves a higher level of industrialization of the agricultural sector, and other basic sectors, a greater degree of nationalization will occur. Locally owned businesses are given priority in competition for government contracts.

With respect to companies organized and operating in the Central American Common Market, exchange and remittance restrictions are partially waived if they are for amortization of trade accounts payable.

OWNERSHIP RESTRICTIONS:

Foreign ownership of newspapers and televison or radio stations and the operation of coastal shipping is restricted.

Foreign ownership of Nicaraguan airlines is restricted.

Foreign ownership of financial and insurance institutions is prohibited.

Direct or indirect foreign ownership of rural real estate is strictly regulated. Rural real estate must be constantly and efficiently exploited, and at least 75 percent of the area should be in use.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through nationalized banks authorized to deal in foreign exchange, and through registered brokers.

Prior approval by The Central Bank of Nicaragua is required for all foreign currency loans.

The normal fine for infringement of exchange controls is 100 percent of the amount of the related transaction. Higher fines are also applicable.

Infringement of the decapitalization law is penalized by returning to the company the diverted assets or currency, plus a 20 to 50 percent fine to the company. Officials responsible for such infringement may be confined to prison from 1 to 3 years.

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REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the government to ensure repatriation rights.

Any new investment or foreign capital increase must be previously reported to the Central Bank.

Profits may only be remitted on capital brought into Nicaragua or on reinvestements of profits derived from such capital and properly registered with the Central Bank.

Repatriation of capital in excess of the amount registered in foreign currency with The Central Bank is not allowed.

Remittance of dividends and branch profits on registered foreign investment is subject to a 45 percent withholding tax.

Royalties may be remitted by a Nicaragua subsidiary to the foreign parent if properly registered and approved by The Central Bank.

Remittance of service fees is subject to government verification that services have been effectively rendered, and remittance must be approved by The Central Bank.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis.

Two-thirds of the number of employees in all commercial, industrial or other enterprises must be nationals of Nicaragua. Exceptions may be made for skilled laborers and technicians if not available within the country.

In the event of layoffs, nationals of Nicaragua, whose duties are identical to those of foreigners, must be given preferential treatment as regards retention.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Component parts or input for goods produced in Nicaragua must be from locally available sources unless a specific waiver is obtained from the Nicaragua Department of Development of Industry.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: NIGERIA

INTRODUCTION:

The Federal Government of Nigeria actively encourages foreign entities to set up manufacturing and service operations in joint ventures with Nigerians. For the purpose of foreign participation in such ventures, the enterprises are categorized into three schedules. No foreign entities are permitted to engage in activities listed under Schedule One. Under Schedules Two and Three foreigners can undertake joint ventures with equity shares of 40 and 60 percent respectively, while Nigerians contribute the balance. Nigeria is also attempting to induce reinvestment of profits in the country by restricting dividends to 60 percent of profit after tax. Therefore, strict exchange and repatriation controls are exercised to limit the outflow of capital. Locally owned businesses are not given any priority over companies with foreign participation in competition for government contracts. There is no waiver based on the country of origin of the foreign investors or partners in a venture.

OWNERSHIP RESTRICTIONS:

(MAJOR ENTERPRISES LISTED HERE)

SCHEDULE ONE	SCHEDULE TWO	SCHEDULE THREE
	(40 percent foreign participation)	(60 percent foreign participation)
Advertising and relations business; Pools betting; Blending and bottling of alcoholic drinks; Commission agents; Garment manufacture; Estate agency; Film distribution; Radio and television broadcasting.	Banking; Beer Brewing; Basic iron and steel; Manufacture of cement; Food products; Metal containers; Fish and shrimps trawling and processing	Distilling, manufacture of basic industrial products, drugs and medicine; Structural steel produc s; Agricultural machinery and equipment; Electrical appliances; Engines and turbines; Motor vehicles and motorcycles; Machinery and equipment rental.

Technology and contract agreements are subject to government appraisal of necessity of service to be rendered and local availability of technology involved.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected through banks after prior approval has been granted by the Federal Ministry of Finance. Authorized dealers and authorized depositories can transact in foreign currency. Prior approval of the Federal Ministry of Finance is required before all foreign loans are processed through the Central Bank of Nigeria. The normal penalty for infringement of foreign exchange control includes fines and imprisonment or both.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the government to ensure repatriation rights; and capital, loans and technology agreements must be registered and approved to ensure remittance rights. Any new investment or capital increase must be approved by the Federal Ministry of Finance. Profits may only be remitted on capital brought into Nigeria or on reinvestment of profits derived from such capital; remittances of profits are restricted to 60 percent of profits after tax. Capital gains are subject to withholding tax, and remittance thereon must receive the usual exchange control approval. Royalties are remittable after withholding tax. Remittance of service fees is subject to prior clearance of the service agreement with the Federal Ministry of Finance. Expatriates working in Nigeria are allowed to remit fifty percent of their after-tax income.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required by foreign personnel engaged on either a permanent or a temporary basis. The number of foreign personnel is determined under a scheme of expatriate quotas by which foreigners are employed in positions for which qualified Nigerians are not available. There is no restriction on number or portion of remuneration of expatriates vis-a-vis nationals. The government has no regulation over the manner of lay-offs of either foreigners or nationals.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There is no specific percentage here. A high portion of local content in products usually attracts excise duty subsidies.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Pioneer Status: A tax holiday of an initial three years exists for investments in the listed pioneer industry and is extendable by a maximum of two years.

Customs (Drawback) Relief: Importers may in certain circumstances claim repayment of the full import duty if goods are exported in the same state that they are imported, and if materials are imported for use in the manufacture of goods which are also exported. Other measures include imposition of high customs tariffs on imported goods, import restrictions, and full repatriation of dividends or capital provided the industry has Approved Status.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: NORWAY

INTRODUCTION:

Foreigners or foreign corporations outside Norway may freely carry out trading activities with Norwegian individuals or corporations subject to compliance with local regulations concerning import and export licenses.

Norwegian law imposes official controls in various fields and to various degrees. Most of the regulations apply to all enterprises in Norway. However, there are also special regulations for foreigners and for companies which are partly owned by foreigners.

OWNERSHIP RESTRICTIONS:

Foreign corporations and individuals must obtain a concession from the Government to own real estate and, in most cases, to acquire leaseholds. Concessions must also be obtained to acquire rights to mining, forestry, agricultural or hydroelectric properties.

A concession is required for a foreign buyer to acquire more than 10 percent of the shares of a corporation which owns real estate or other rights which the acquirer could not obtain without a concession, or to acquire more than 20 percent of the share capital of a Norwegian industrial corporation.

Foreigners are not allowed to own more than 40 percent of a Norwegian ship. Dispensation from this rule can be given in special cases.

Furthermore, foreign participation is restricted in the following fields:

- Ownership of commercial banks and other financial institutions.
- Ownership of Norwegian aircrafts.
- Operation of domestic airlines.

Even if a concession has been granted, a license from the Central Bank is necessary for the transfer of capital to be invested.

EXCHANGE CONTROLS:

Exchange controls are still in force in Norway, but regulations are liberal. Regulations are based on the Foreign Exchange Act of 1950, the control of which is exercised by the Norwegian Central Bank.

All transfers of foreign funds to Norway by non-residents for investment purposes are subject to approval by the Central Bank.

The consent of the Central Bank is also required if the investment concerns foreign participation in newly established Norwegian companies or the purchase of shares in existing companies, regardless of whether the investment is made for financial purposes (only if investment exceeds NOK 1 million) or in order to gain some control over a company's operation.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Where investments are permitted by the Central Bank, dividends, profits from business activity in Norway, interest and contractual amortization on loans and interest on debentures and mortgages, and repatriation of invested capital are freely and fully remittable.

A foreign employee working in Norway can freely transfer wages, fees and other remunerations to his home country. When leaving Norway, he can freely transfer his capital savings.

EMPLOYMENT RESTRICTIONS:

A temporary ban on immigration is presently in effect in Norway for citizens from nations other than Denmark, Sweden and Finland.

The ban does not apply to foreigners on short-term employment in the petroleum industry in the North Sea, or for specialists and key personnel required to run a business enterprise.

A foreigner who wishes to work in Norway must obtain a work permit and a visa. Application forms and further information are available from any Norwegian Embassy or Consulate General.

Wages, working hours and conditions, etc. offered to foreign labor must follow Norwegian laws and regulations and should not be inferior to those applicable for corresponding work done by Norwegians.

LOCAL MATERIAL CONTENT REQUIREMENTS:

No such requirements exist except for deliveries exceeding NOK 1 million in respect to North Sea Oil developments, where the operators of the fields are governed by separate requirements to use Norwegian suppliers provided they are competitive.

OTHER RESTRICTIONS:

Norwegian authorities are positive toward foreign investments.

Prices, monopoly and antitrust regulations exist in Norway according to the Price Control Act of 1953.

Authorities are empowered to supervise restrictive business practices and dominant enterprises and issue regulations on prices, profits, production and distribution.

Various security and other regulations exist in respect to the oil production industry.

Industries with pollution problems (air/water) must obtain approval from the Pollution Council.

A special law regarding control of business establishments has been in effect since 1977.

The purpose of this Act is to give the authorities an incentive to stimulate and disperse economic activity in accordance with the national development policy, i.e., to reduce business establishments in the urban areas in favor of establishments in less developed areas.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

No specific incentives are available to foreign investments only.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PAKISTAN

INTRODUCTION:

Pakistan actively encourages foreign entities to set up local manufacturing operations. This policy is likely to continue. Foreign technology and capital are considered contributary to rapid industrialization. In 1972 when control of certain categories of industries was taken over by the government, exception was made for units having foreign participation. Industrialization policy is motivated by a desire to improve the standard of living and provide employment to nationals, exploit natural resources, support agriculture and improve the balance of payment position. To further improve the balance of payment position, an export processing zone (EPZ) is being established at the outskirts of Karachi, primarily for foreign entities. There are statutes protecting foreign capital and industrial property. A mixed economic policy is being followed with a bias in favor of the private sector. There are strict exchange regulations on the outflow of funds. These restrictions are not applicable in the EPZ. Local and foreign entities established in Pakistan are treated at par for government contracts. There are investment guarantee agreements between the government of Pakistan and the governments of the USA, Canada, West Germany and Libya. There are also double taxation agreements with a number of countries.

A new concept of financing based on profit sharing has been introduced in Pakistan called "Modaraba." Profits of "Modaraba" are exempt from income tax if 90 percent or more of the profits are distributed, whether in cash or stock.

OWNERSHIP RESTRICTIONS:

Foreign entities require permission from the Investment Promotion Bureau of the Government of Pakistan to set up an office or an undertaking.

Although there is no ban on foreign ownership in any industry other than armaments and the like, investment is preferred in capital intensive high technology industries or undertakings which break new grounds in promotion of industry established in the past in Pakistan. Collaboration in basic industries with public sector industries is also encouraged.

Investment in already well established basic consumer goods industries is not encouraged.

Technology agreements are subject to government appraisal of necessity of the service to be rendered and local availability of the technology involved.

Industries preferred in the EPZ are export-oriented, involving high value-added or processing of local raw materials or intensive labor. Industries competing with export-oriented industries in Pakistan as well as armaments, narcotics, distilleries and breweries are not permitted.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange.

Prior approval of foreign currency loans is required unless arranged through industrial finance institutions in Pakistan.

Local currency bank borrowings for working capital are regulated by the State Bank of Pakistan (central bank).

Imports and exports regulated:

Foreign currency accounts with authorized banks are permitted under an overall scheme approved by the State Bank of Pakistan.

In the EPZ most restrictions are lax.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be approved by the government to ensure repatriation rights. Capital loans, technology and royalty agreements must be approved to ensure remittance rights. Any new investment or capital increase also requires approval. Profits may only be remitted on capital brought into Pakistan or on reinvestments of profits derived from such capital and invested in approved industrial projects with the approval of the government. Appreciation of capital investment may be permitted by the State Bank of Pakistan subject to prevailing exchange control regulations.

EMPLOYMENT RESTRICTIONS:

Work permits are required for employment of all foreign personnel. A comparatively liberal policy in granting work permits to foreign technicians/experts exists where local substitutes are not readily available.

Terms of employment and remittances are regulated.

LOCAL MATERIAL CONTENT REQUIREMENTS:

All imports other than for the EPZ are regulated through import permits which are not normally issued for locally available material.

OTHER RESTRICTIONS:

Managing agencies are not permitted other than in the case of "Modaraba" companies.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Five year tax holidays are granted to companies establishing specified approved industries anywhere in Pakistan or any approved industry in specified areas. Partial tax relief for a certain period may be available to certain companies. Income from agriculture is exempt, and income from specified farming activities is exempt until June 1983.

In EPZ, a five year tax holiday is available from the commercial production date. This may be extended on a case-by-case basis. After expiration of the tax exemption period, tax is charged at 25 percent of normal rates. Income accruing or arising outside of Pakistan is exempt.

Income of foreign personnel attached to concerns in the EPZ is exempt from tax for five years.

The salaries of foreign technicians under contract are exempt for three years if approved by the Commissioner of Income Tax.

Dividend income from manufacturing public companies established during a certain period is exempt from tax for five years from date of commercial production. In case of non-manufacturing public companies, dividend is paid out of income accruing up to a certain period.

Capital gains are exempt from tax for a certain period.

Rebate is allowed in tax on profits attributable to export sales of manufactured goods. A tax credit of 15 percent of cost of machinery installed up to a certain period in existing industry is allowed. A tax credit of 30 percent or 15 percent of amount invested is also allowed, in acquisition of share capital of a Pakistani company having industrial undertakings located in specified areas.

Concessions in import levies and sales taxes on plant and equipment are granted in certain cases.

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NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PANAMA

INTRODUCTION:

Panama encourages foreign entities to set up local manufacturing and assembling operations. This policy is part of an overall effort to industrialize Panama and to provide employment for its nationals. Also, Panama encourages foreign entities to operate in the Colon Free Zone to provide employment for residents of the City of Colon. There are no exchange controls, no requirements for the registration of capital, and no controls over the repatriation of capital or retained earnings.

In general, there are no restrictions on foreign ownership. The Panamanian Constitution provides that citizens and foreigners are equal under the law. However, various laws may subject foreigners to special conditions or deny them the right to engage in certain activities. At the present time foreigners may engage in any business except the retail trade and, in addition, certain professions are restricted to nationals.

OWNERSHIP RESTRICTIONS:

Retail business
Certain professions

EXCHANGE CONTROLS:

None

REPATRIATION OR REMITTANCE RESTRICTIONS:

None

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis. In terms of both number or remuneration, ninety percent of employees of all commercial, industrial or other enterprises must be nationals of Panama, including foreigners married to Panamanians or foreigners with ten years residence. Foreign specialists and technicians may not exceed 15 percent of the total number of employees and total compensation. Authorization may be requested from the Ministry to exceed the 15 percent limitation.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Panama provides tax incentives to companies establishing manufacturing operations in Panama, such as exemption from the income tax on export sales. In addition, companies producing entirely for local consumption are entitled to the following:

- Exemption from income tax on the net earnings reinvested in fixed assets, to increase capacity or to produce new products, provided that the amount reinvested exceeds 20

percent of net taxable income of the fiscal year in which the expansion is made. Only the amount in excess of the 20 percent is exempt from income tax.

- Three years carry forward loss.

In addition, the importation of machinery and equipment used in manufacturing operations is exempt from import duties.

In order to have the above incentives a contract with the Panamanian Government is required. The contract could have a term up to 15 years.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PAPUA NEW GUINEA

INTRODUCTION:

The PNG Government policy is, at present, to encourage foreign investment on a selective basis. The National Investment and Development Authority (NIDA) is responsible for coordinating the implementation of Government policies towards foreign investment. NIDA issues a priorities schedule on a regular basis which indicates those types of industries in which it wishes to encourage investment. The Government has indicated that it no longer supports foreign investment in the extractive industries purely for the purpose of supplying raw materials to overseas manufacturing operations of the foreign investor. Generally, foreign investment which reduces dependency on imported manufactured goods and expands local manufacturing is welcomed. Locally owned businesses are given priority in competition for Government contracts.

OWNERSHIP RESTRICTIONS:

The National Investment and Priority Schedule sets outs details of:

- o Priority activities where foreign investment is considered essential. Examples of these industries include:
  - -- Development of mining and petroleum projects
  - -- Growing of legume and grain crops

- -- Forestry and integrated forest industries
- -- Fishing and integrated fishing industries
- -- Shipbuilding and ship repair industry
- -- Tourist facilities

o Industries and products for which investment proposals are encouraged and welcome with interest; and

o Reserved activities, those activities in which foreign investment is not as a general rule Permitted. This group contains 36 reserved activity classifications including:

- -- Growing, processing and trading of coconut and coffee
- -- Poultry farming
- -- Small scale crocodile farming
- -- Coastal fishing
- -- Manufacture and retail of handicrafts and artifacts
- -- Operation of small scale snack bars, taverns and guest houses

Generally speaking, because of the scale and nature of these activities, we would not expect foreign investors to be interested in investing in the industries reserved for Papua New Guineans.

Foreign enterprises exclusively engaged in drilling, seismic survey and other forms of exploration for minerals and hydrocarbons are exempt from NIDA registration. Investors contemplating developing major resource projects are required to settle the conditions of the project by negotiation with the

Government. The agreement usually grants the Government the option of acquiring a stipulated percentage equity.

There are no formal requirements for local equity participation in new enterprises. However, foreign investors are encouraged to allow some local participation.

EXCHANGE CONTROLS:

The Bank of Papua New Guinea (the Central Bank) administers exchange control in PNG. The trading banks operating in the country have certain delegated authority from the Central Bank. Exchange control policy has been applied in a fairly practical manner with a view to preserving domestic and external confidence in PNG's financial situation and prospects. The following principles are generally applied:

- All reasonable payments on current account are normally approved.
- Repatriation of non-residents' capital is normally approved. This also applies to the surplus earnings of temporary residents and emigrants' capital.
- There are restrictions on overseas capital investment by PNG incorporated companies and permanent residents.
- Export proceeds must be returned to PNG.
- The inflow of funds from non-residents is normally permitted for approved investment projects.

Central Bank approval is required for all foreign investment proposals.

Taxation clearance is required for payments of a capital nature to:

Hong Kong
Solomon Islands
Vanuatu.

Clearance is alspo required for capital payments in excess of Kina 10,000 per annum to:

Australia
Federal Republic of Germany
Japan
New Zealand
Philippines
Singapore
Switzerland
United Kingdom .

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no general restrictions on the repatriation of capital by non-residents.

Applications for all types of current account payments are readily approved. No formalities are involved in the payment for imports where documents are available evidencing receipt of the goods into the country.

Remittance of dividends to overseas parent companies is subject to a 15 percent withholding tax.

There is no restriction on the remittance of branch profits to an overseas head office.

EMPLOYMENT RESTRICTIONS:

All employers must have an approved training and localization program before they may employ non-citizens. Work permits are required for all non-citizen personnel and will only be issued on the basis of the training and localization program submitted.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Entities which receive NIDA approval are required as a condition of that approval to use supplies and services available within PNG, preferably furnished by Papua New Guineans, provided that those items are readily available at prices and of a quality similar to these obtainable elsewhere.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The Government is willing to provide financing for the infrastructure of approved new projects in return for a negotiated user charge.

An income tax incentive is available for certain manufactured goods which are exported from PNG. There are 42 categories of goods which are eligible for this incentive.

One-half of the export sales income in excess of the average export sales income over the preceding three years is exempted from income tax. Expenses incurred in deriving the exempt export income are not deductible for income tax purposes.

This incentive is available for seven consecutive years from the year in which the exemption is first obtained.

OTHER RESTRICTIONS:

None.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PARAGUAY

INTRODUCTION:

The Government's policy is to welcome foreign investment provided it contributes to the country's economic and social development.

In general, all forms of business activity are open to the foreign investor, but special preference is given to those which contemplate using local raw materials and labor.

The Investment Promotion for Economic and Social Development Law No. 550 grants specific benefits, permits the repatriation of capital and profits, and provides guarantees against inconvertibility.

All potential growth areas are open to foreign investors, including the raising of vegetables and fruits, tea, oleaginous seeds, corn and pork, the production of pulp, cellulose and paper, fertilizers, leather and footwear, agricultural tools and machinery, electrical equipment and appliances, and increased mechanization of all stages of production. Foreign investment and management are accepted by the trade unions.

OWNERSHIP RESTRICTIONS:

None

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange and through registered brokers.

Banks form the free exchange market, and the rate of exchange in this market is set by the Paraguayan Central Bank. Registered brokers form the fluctuating exchange market, and the rate of exchange in this market is set by supply and demand.

Loans in foreign currency must be registered at the Paraguayan Central Bank in order to ensure the remittance of amortization and interest at the rate of the free exchange market.

REPATRIATION OR REMITTANCE RESTRICTIONS:

The recovery of capital paid in under the provisions of the law on foreign investments -- which grants special benefits -- can begin after the third year of production or exploitation in annual installments which must not exceed 20 percent of the paid-in capital.

Foreign investments resulting from loans must be first approved by the Paraguayan Central Bank to ensure the recovery of capital and the payment of interest in accordance with the system established by the contract and at the rate of the free exchange market.

The remittance of dividends, profits, interests, royalties, fees, rents or any other earnings from Paraguayan sources is subject to withholding in lieu of taxes.

EMPLOYMENT RESTRICTIONS:

In keeping with current labor law, whenever qualifications are equal preference must be given to Paraguayan workers.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Foreign investments enjoy either total or 50 percent exemption from all applicable national taxes.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PHILIPPINES

INTRODUCTION:

The Philippine government encourages foreign capital to establish pioneer enterprises that are capital intensive. The government is also seriously considering an industrial development program over a span of 5 years involving 11 major projects, such as: copper smelter, phosphatic fertilizers, aluminum smelter, heavy industries, integrated steel mills, petrochemical complex, diesel engines, cement, coconuts, alcogas, and pulp and paper. To attract foreign capital into the Philippines, the government has adopted new rules liberalizing and encouraging foreign investments, such as the liberalization of Central Bank regulations on the remittance of profits and dividends, and repatriation of capital, the reduction of income tax in certain cases, the liberalization of immigration rules for foreign investors, and other non-tax incentives. The government also offers a package of incentives in "preferred areas" of economic activity. Locally owned businesses are given priority in competition for government contracts but only in nationalized activities. There are no waivers of exchange and remittance restrictions to companies organized in any specific country.

OWNERSHIP RESTRICTIONS:

Foreign ownership of newspaper, television or radio stations and firms engaged in retail trade is prohibited.

Foreign ownership and operation of domestic airlines or air transportation is restricted to minority participation.

Foreign ownership of financial institutions is restricted to minority participation.

Foreign ownership and operation of coastwide shipping is restricted to minority participation, except for Americans who are allowed up to 75 percent.

Direct or indirect foreign ownership of real estate is strictly regulated.

Technology agreements are subject to government appraisal and approval.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in foreign exchange and through registered foreign exchange dealers.

Prior approval of the Philippine Central Bank is required for all foreign currency loans and domestic borrowings.

High fines and penal sanctions may be imposed for infringement of exchange control.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the Central Bank to ensure repatriation rights.

Capital, loans and technology agreements must be registered to ensure remittance rights.

Any new investment or capital increase must be reported to the Central Bank (CB) and Board of Investment (BOI) within a prescribed period.

Technical service agreements must be registered to ensure remittance rights.

Remittance of royalties and service fees is subject to withholding tax and prior CB approval.

Profits may only be remitted on capital brought into the Philippines or on reinvestment of profits derived from such capital.

Remittance of dividends and branch profits on registered foreign investment and capital are subject to withholding tax.

Repatriation of capital in excess of the amount registered in foreign currency with the CB, i.e., capital gains, is subject to withholding tax and requires approval by the CB.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis. Work permits are valid for 2 years and may be renewed.

Foreign personnel may be hired due to non-availability of nationals qualified and willing to perform the work, and to train nationals in the work performed by foreign personnel.

Prior approval of the Ministry of Labor is required for the transfer of personnel to another job, or for a change of employer.

No work permits are required for foreign employees of regional/area headquarters of multinational companies, officers of foreign investment houses, foreign investors, or stockbrokers investing in the Philippines.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Under BOI guidelines implementing the Progressive Car Manufacturing Program (PCMP) of the government, certain component parts of automobiles or cars manufactured and assembled in the Philippines must be manufactured locally.

OTHER RESTRICTIONS:

Foreign companies or companies with at least 40 percent foreign equity are required to maintain stipulated proportions of debt-to-equity before they are allowed to avail themselves of domestic borrowings.

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BOI registration of foreign equity is required if it exceeds 30 percent of total capital.

Publication is required and hearings are conducted by BOI if objections are received on application for 100 percent foreign ownership of certain business undertakings due to nationality limitations and if the area of investment is included in the overcrowded list.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The Philippines provides a 15-year tax holiday to companies establishing pioneer manufacturing operations in the Philippines. In addition, the government grants deduction of organizational and pre-operating expenses for 10 years from the start of operations and accelerated depreciation of their fixed assets, allows a net operating loss carryover for 10 years from the start of operations, tax exemption on imported capital equipment and a tax credit on domestic capital equipment used in manufacturing operations in the Philippines. Tax credit for withholding tax on interest payments on foreign loans, the employment of foreign nationals in supervisory, technical or advisory positions for 5 years extendable for limited periods, and the deduction of labor training expenses are also granted. The Philippines government also guarantees anti-dumping protection, protection from goverment competition (importation by government agencies of products or items tax and duty-free that are being manufactured or produced by the registered enterprise), protection of patents and other proprietary rights, repatriation of investment, remittance of earnings and proceeds of foreign loans and contracts arising from technological assistance, and freedom from expropriation of investments or properties and the requisition of investments.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PORTUGAL

INTRODUCTION:

Foreign investment in Portugal is regulated by law and is subject to advance approval. The principles underlying the law include the recognition that foreign investment is of interest to the country's economy provided it creates new jobs, uses local resources, introduces advanced technology and contributes towards the balance of payments. Repatriation is subject to exchange controls. There is no discrimination when granting incentives or awarding government contracts. The trend is towards a greater liberalization of the economy. At present, radio, television, banking, insurance, public utilities, transport, port authorities, petroleum refining and related base chemicals, fertilizers, cement and munitions are industries closed to private enterprise.

OWNERSHIP RESTRICTIONS:

There are no restrictions on industries open to the private sector.

Non-resident corporations may not directly acquire real estate.

EXCHANGE CONTROLS:

All transactions involving foreign exchange must be authorized in advance of their effective dates. Inward capital and its subsequent repatriation, together with loans and technology agreements, must be supported by investment permits. Goods and services must also be supported by import or export licenses.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Repatriation of proceeds on the sale of authorized investments may be limited to 20 percent per annum. No capital gains tax is assessed. The profits net of withholding tax are freely remittable; however, the authorities currently impose a one-third ratio of equity to total assets.

The remittance of interest, royalties and service fees, net of applicable withholding tax, is authorized more or less automatically.

EMPLOYMENT RESTRICTIONS:

Expatriates working in Portugal require both residence and work permits. Generally, business enterprises are not entitled to employ expatriates exceeding in numbers 10 percent of the total staff.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

Tax and non-tax incentives apply to authorized investments regardless of whether held by foreigners or Portuguese nationals. Incentives relating to projects involving an investment in fixed assets and net working capital in excess of $15 million are negotiated on a case-by-case basis. All other investments are grouped into four categories on a points system. Benefits of between three to nine years tax holiday may increase according to the number of points attributed.

Non-tax incentives comprise reduction of interest rates, employment and operating subsidies, and investment grants.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: PUERTO RICO

INTRODUCTION:

Puerto Rico actively encourages and welcomes foreign entities to set up operations on the Island, both in the manufacturing and the services industries. After nearly three decades of emphasis on low-capital, labor-intensive enterprises, the government has restructured its investment incentive policies to ensure flexibility as well as stability in the manufacturing sectors. No limitations are imposed on repatriation and distributions of earnings, although tax incentives are granted to promote reinvestment of such profits within the Island. There is free movement of funds both to and from Puerto Rico, and there are no major restrictions to foreign investors in potential growth areas. However, locally manufactured commodities are given a slight advantage on bids for government contracts. It should be noted that due to the special political ties between Puerto Rico and the U.S., a number of Federal laws and regulations are applicable to operations in the Island. Non-U.S. investors might receive slightly different treatment than that accorded to U.S. nationals.

OWNERSHIP RESTRICTIONS:

There are no major limitations on foreign ownership of real or personal property within the Island. Nonetheless, there is an absolute limitation on the possession of more than 500 acres of land, which applies to both residents and non-residents of Puerto Rico.

The Secretary of the Treasury must approve the transfer of 5 percent or more ownership of banks, and preference is given to domestic over foreign buyers of bank shares. Public utilities are government owned, and thus private investment in this area is unlikely and, in any event, not possible without government approval.

EXCHANGE CONTROLS:

The currency of Puerto Rico is that of the United States, the base unit of which is the U.S. dollar.

There are no exchange controls on transactions in foreign currency within the Island. However, transfers must comply with Federal regulations. Thus, transactions in foreign currency (not U.S. dollars) in excess of $10,000 should be reported to the Federal government.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Except as restricted by U.S. Federal Regulations, there are no legal restrictions imposed on the flow of funds into or out of Puerto Rico. However, certain remittances are subject to withholding tax at the source.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are necessary for non-U.S. citizens hired on either a permanent or temporary basis.

Most U.S. laws and regulations relating to employment insurance, health and safety must be complied with.

LOCAL MATERIAL CONTENTS REQUIREMENTS:

No major requirements.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

Substantially all of the non-tax incentives offered to industries in Puerto Rico are under the programs of the Economic Development Administration (FOMENTO) and its subsidiary, the Puerto Rico Industrial Development Company (PRIDCO). They include training payroll and other training cost subsidies, payroll incentives, site selection, and low-cost rental of plant facilities. Assuming that the business qualifies as an investment vehicle for Section 936 funds, it should be possible to obtain favorable financing in Puerto Rico at below market rates.

Effective January 1981, minimum wage rates were increased to approximate U.S. levels. Nevertheless, it is still possible to obtain productive unskilled labor at relatively low labor rates as compared with most developed economic environments.

A number of U.S. Federal agencies provide technical and other forms of assistance to investors planning to invest in the United States. Most of these agencies operate in Puerto Rico, and their programs generally apply equally to Puerto Rico and the United States.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: QATAR

INTRODUCTION:

Qatar is essentially a capital exporting country with substantial funds for investment. Foreign investment is encouraged only to the extent that it provides additional technical or commercial expertise which is not available locally. Any viable project is welcomed within the overall constraint that all companies must be at least 51 percent owned by Qatari nationals or, in the case of branches, be sponsored by Qatari nationals. The small native population means that the creation of new employment is not a major factor in attracting new investment, while the steady development of the infrastructure and industrial base is the main priority.

OWNERSHIP RESTRICTIONS:

There are no specific restrictions within the general rule that a foreign partner can not hold more than 49 percent of any company. Land can be held only by Qatari nationals. However, in practice, inward investment may be restricted to areas requiring foreign technology or very large capital contributions where local resources are inadequate.

EXCHANGE CONTROLS:

There are no exchange control regulations in Qatar.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There is no restriction on the repatriation of capital or profits, and the movement of funds is unrestricted.

EMPLOYMENT RESTRICTIONS:

Work permits are required for all foreign nationals (and entry visas for most) working in Qatar on either a permanent or temporary basis. There is, however, no particular restriction on the nationals from any one country being employed, although in practice Arab nationals are given preference.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

There is a general embargo on any companies which have dealings with Israel and who are named by the Israel Boycott Office.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

None

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SAUDI ARABIA

INTRODUCTION:

Saudi Arabia encourages foreigners to invest their capital and to share their expertise and knowledge with Saudi nationals in industrial development projects. Although certain regulations and restrictions are imposed, many incentives are offered to attract foreign investors to Saudi Arabia. The government of Saudi Arabia also provides assurances to maintain private ownership and to avoid any new restrictions on currency movements.

OWNERSHIP RESTRICTIONS:

- Mineral rights are reserved for the State and State owned companies. Foreign investors may participate in "downstream" oil related ventures, usually on a 50 percent ownership basis.
- Foreigners are not permitted to have local agencies or to register as commercial agents.
- Commercial activities are confined to Saudis.
- Foreign ownership of real estate is prohibited.
- Foreigners are not permitted to import products or materials to the Kingdom unless they have a Saudi agent.
- Foreign investment is made under the Regulations on Investment of Foreign Capital which approves such investment plans based on the benefits to the country.

EXCHANGE CONTROLS:

There are no restrictions imposed on foreign currency transactions, excluding those of Israel and South Africa.

REPATRIATION OR REMITTANCE RESTRICTIONS:

- No restrictions exist on the repatriation or remittance of capital, income, or profits to the extent that these profits are not legally reserved.
- Remittance for services, consultation or management fees are subject to Saudi tax unless the foreign payee is considered "not operating in Saudi Arabia."
- Foreign home office expenses are subject to tax. Provisions for exclusion exist.

EMPLOYMENT RESTRICTIONS:

- Entry visas and work permits are required for all foreigners hired on either a permanent or temporary basis. Those foreigners staying in the country over 3 months require a residence permit. Both permits require an employment contract and the surety of a Saudi employee.
- A public transport operator must be a Saudi national.
- The number of Saudi employees in a company must not fall below 75 percent or their remuneration below 51 percent of the total (this restriction is not practically applied at the present time).

LOCAL MATERIAL CONTENT REQUIREMENTS:

- All Israeli or South African goods, materials, or products which include any components manufactured in those countries, are not permitted in Saudi Arabia.
- Alcoholic beverages are not permitted in Saudi Arabia.

OTHER RESTRICTIONS:

- All foreign or Saudi projects with fixed assets (excluding land and buildings) of one million Saudi Riyals or more must obtain an industrial license.
- All companies established in Saudi Arabia are required to apply for Commercial Registration within one month from the date of formation. Those companies are required to register each branch, agency, office, contract or subcontract.
- All foreign contractors who do not have a Saudi partner must appoint a registered Saudi national as commercial agent.
- Financial and commercial transactions with Israel and South Africa are prohibited.
- Any entity or any of its affiliates having business affairs in Israel shall be boycotted.
- Foreign companies established in Saudi Arabia may not open a new branch, agency or office nor may they issue new securities without prior permission from the government.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Saudi companies may be entitled to one or more of the following:

- Saudi Arabia may grant the foreign investor a five-year tax holiday for economic development projects (or ten-years for agricultural or industrial projects) provided that there is a minimum 25 percent Saudi participation throughout the period of exemption.
- Provisions provide for loans and equity participation on favorable terms.
- Assistance in forming, organizing, selecting the industrial project and in conducting feasibility studies.
- Provisions for financial and technical subsidies.

- Exemption of imported equipment and raw materials from custom duties.
- Industrial sites offered at favorable rent.
- Subsidies granted for training Saudi nationals.
- Provisions for protective customs tariffs and assistance in exporting products.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SINGAPORE

INTRODUCTION:

Singapore welcomes foreign private investments, particularly industrial projects requiring high technology or which are export oriented. The country's development has followed basic policies calling for the encouragement of private enterprise; cooperation among business, labor, and government; equitable employment practices, including productivity-related wage levels; modernization and expansion of the infrastructure; expansion of technical education; investment incentives; and active support of all practical regional development projects.

Emphasis is being placed on those industries with worldwide markets and scope for progressive growth in technological content. Industries are encouraged to increase their productivity through automation and better use of labor.

Although the government would like to see local participation in foreign-owned companies carrying on business in Singapore, this is not normally a condition for approval for setting up a foreign business there.

OWNERSHIP RESTRICTIONS:

There are no percentage restrictions on the foreign ownership of businesses in Singapore. Licenses are required from the Monetary Authority of Singapore to undertake banking, installment, purchase, and insurance businesses. There are restrictions on

non-Singapore citizens acquiring equity interest in locally incorporated banks. The ownership of companies publishing newspapers in Singapore is subjected to legislative control. Non-Singapore citizens require government approval to own certain residential properties. However, such approval is not necessary in the case of condominiums or residential flats or apartments in a building which has not less than six stories.

EXCHANGE CONTROL:

There is no exchange control in Singapore.

REPATRIATION OR REMITTANCE RESTRICTIONS:

In the absence of any exchange control, no approval is required for payments, remittance, or capital transfers in any currency to any country. Thus, earnings and capital can be remitted abroad freely.

EMPLOYMENT RESTRICTIONS:

Employment passes, usually for one to three years, are issued to executives of large corporations, well-qualified specialists, or persons required to start up new industrial, financial or service undertakings. Permanent residents who are non-citizens and are earning not more than $750 per month are required to obtain work permits under the Regulation of Employment Act.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no local material requirements, as such. However, this factor may be taken into consideration in granting tax incentives.

OTHER RESTRICTIONS:

Industries Closed to Private Enterprise

The manufacture of arms and ammunition and the provision of public utility services, such as the supply of electricity, gas and water, are closed to private enterprise. Similarly, the telecomunications system in Singapore is operated by a government statutory board.

Import Restrictions

Most goods can be imported freely under open general license. However, import licenses are required for goods originating in or consigned from Albania, Cuba, Czechoslovakia, the German Democratic Republic, Vietnam, the People's Republic of China, and the People's Republic of Mongolia. Certain categories of goods require import licenses. All imports from South Africa are prohibited. A selected number of commodities, such as rice and refined sugar, require specific import licenses.

Export Licenses

Export licenses are required for goods such as steel bars, cement, wines, certain types of bottles, raw feathers, granite, scrap metal, sand, sugar, condensed milk and rice.

Manufacturing Licenses

Specific manufacturing licenses are required for the following products:

- Food--beer and stout

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- Wood and paper--playing cards, veneer and particle board
- Rubber--tires
- Non-metallic products--cement
- Chemicals--detergents, fire crackers
- Metals--pig iron, sponge iron, steel ingots, blooms, slabs, rolled and drawn steel products
- Electrical--television receivers, air conditioners, refrigerators, fluorescent lamps and tubes
- Miscellaneous--matches, cigarettes, optical lenses, safety helmets and belts and other safety products.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Tax Incentives:

Inward Investments: The Singapore Government actively encourages foreign investment and has introduced legislation granting substantial tax incentives in order to attract both foreign and local investment.

Capital Investment: An industrial enterprise can claim accelerated depreciation allowance at the rate of 33-1/3 percent per annum using the straight-line basis on machinery and equipment. Buildings do not qualify. An "industrial enterprise" is defined as a trade or business carried on in a mill, factory or similar premises, which utilizes machinery and equipment in the manufacture of goods or materials or the subjection of goods and materials to any process.

Tax Concessions: The Economic Expansion Incentives (Relief from Income Tax) Act provides for the tax incentives. The term "approved" below means approved by the Minister for Trade and Industry.

o **Pioneer Industries**

An approved pioneer industry may be granted exemption from income tax for five to ten years. Except in very special cases, exemption will be granted on the amount of profits after deduction of capital allowances. Tax is not deductible from payment of dividends paid out of exempt pioneer profits earned; and such dividends, other than preference (preferred stock) dividends, remain exempt from Singapore tax in the hands of recipient shareholders. The effect of this exemption upon liability of overseas recipients in their country of residence may be influenced by the terms of any tax treaty with that country. Profits earned after the expiration of the pioneer period are regarded as arising from a new business and are taxable in the normal way.

o **Export Profits**

An approved enterprise engaged in deep-sea fishing or in manufacturing any approved product in Singapore either wholly or partly for export, may be granted exemption in respect of 90 percent of the increased export profits over a fixed base. For a non-pioneer enterprise, the exemption period is five years. For a pioneer enterprise, the exemption is for a further period of three years after the expiration of the pioneer period. In very special cases, exemption may be granted for fifteen years. The position with regard to dividends paid out of exempt export profits is the same as for dividends paid out of exempt pioneer profits.

o **Expansion by Established Enterprises**

An approved enterprise which has incurred expenses of more than S$10 million on productive equipment in expanding its plant may be granted a measure of tax relief for up to five years from the date on which the newly added equipment starts to operate. The relief applies to the increase in income arising as a result of the plant expansion. The relief given is that proportion of the expansion in profits since the prerelief period which bears the same proportion to the expanded income as the new capital expenditure bears to the total cost of all productive equipment. Capital allowances must be deducted in arriving at the expansion profits. The position with regard to dividends paid out of exempt expansion income is the same as for dividends paid out of exempt pioneer profits.

o **Royalties**

The Incentives Act provides that a company engaged in any industry which pays or desires to pay royalties or technical assistance fees or contributions to research and development costs may apply to the Minister for approval of such payments. The granting of approval has the following consequences:

- Tax would be payable at the reduced rate of 20 percent (instead of the normal rate of 40 percent).
- In cases where the Minister considers that the national interest would thereby be served, the approved payments may be totally exempted from tax.
- In cases where foreign recipients of such payments convert them into equity of the manufacturing firms operating in Singapore, such payments may be exempted from tax.

The relief or exemptions referred to above are applied only where they do not result in an increase in the tax liability in the non-resident person's country of residence.

o **Investment Allowance**

The investment allowance is an alternative to the existing pioneer and export incentives for approved manufacturing and related servicing companies discussed above. Tax exemption is granted on an amount of income based on a specified percentage (not exceeding 50 percent) of fixed capital expenditure. The specified percentage and the amount of fixed capital expenditure on which it is to be applied is at the discretion of the Minister. The allowances are granted over a five-year period. However, the balance of the investment allowance that has not been used may be carried forward until fully absorbed. Dividends paid out of profits exempt from tax as a result of the investment allowance are tax free in the shareholder's hands. The investment allowance does not interfere with the claim of normal or accelerated capital allowances under the Income Tax Act.

o **International Trading Companies**

An international trading company that exports in excess of S$10 million per annum of qualifying Singapore-manufactured goods or domestic products, or is an

entrepot trader in non-traditional commodities where annual export sales exceed S$20 million, may apply for tax exemption on half its export profits. Export profits are calculated on a proration of total profits in the ratio of the sales. The tax relief is limited to export revenue in excess of a predetermined base level. Dividends out of tax-exempt profit are tax free in the hands of the shareholder.

- <u>Warehousing and Servicing Incentives</u>

  This incentive would benefit (a) a warehousing company or (b) a technical or engineering company, provided new fixed capital expenditure exceeds S$2 million. The tax relief is similar to that for international trading companies in that, for a five-year period, half the export profits (computed as for inernational trading companies) from export sales or export services are tax exempt. Dividends out of exempt profits are also tax free to the shareholder.

- <u>International Consultancy Services</u>

  This incentive is available to consultancy or engineering firms, not necessarily corporations, providing consultancy services in respect of any overseas project. The provisions for tax relief on export profits and dividends are similar to those for international trading companies.

<u>Research and Development Organizations</u>: In a move to make Singapore a "brains" center for Asia, various tax incentives are given to research and development (R&D) organizations to use Singapore as their base. The incentives include:

- A tax deduction for R&D expenses which are not usually tax deductible.

- A double tax deduction for R&D expenses which are normally deductible.

- Tax depreciation allowances on R&D buildings as "industrial buildings" and investment allowances in addition to accelerated depreciation allowances (33-1/3 percent, straight line) for machinery and equipment.

Financial Center

- Offshore Income of ACU

  To encourage the growth of the Asian dollar market in Singapore and to assist in providing resources to finance projects in the region, offshore income earned by Asian Currency Units (ACU--a department of a bank licensed to carry on offshore banking) of financial institutions from qualifying activities is subject to income tax at a reduced rate of 10 percent instead of the normal rate of 40 percent.

  Qualifying activities of an ACU include:

  - Loans to persons outside Singapore to be used outside Singapore in currencies other than the Singapore dollar;

  - Financing offshore trade transactions through bills of exchange or letters of credit;

  - Loans, deposits,and certain other transactions with other ACUs in Singapore; and

  - Managing Asian Dollar Bonds and providing other financial advisory services to persons outside Singapore.

- Interest

  Exemption from tax is granted to non-resident individuals and to companies not doing business or having a permanent establishment in Singapore in respect to interest from deposits in an "approved" bank, i.e., a commercial bank, and certain merchant banks operating in the Republic. Interest paid by a company engaged in any industry to non-resident persons on approved loans of not less than S$200,000 advanced for the purchase of productive equipment is also exempt from tax, provided that such exemption does not result in an increase in liability to tax for the foreign lender in his country of residence. Interest paid on interbank/interbranch transactions by approved banks in Singapore is not subjected to withholding tax (exempted under Ministerial remissions).

- Offshore Reinsurance

  As in the case of offshore income from qualifying activities of an Asian Currency Unit, tax is payable at the rate of 10 percent on the income of an insurance company derived from accepting general insurance and general reinsurance covering offshore risks, and on the dividends and interest derived by the insurance company from the investment of its income arising from its business of insuring and reinsuring offshore risks. The reduced rate does not apply to life insurance.

- Offshore Gold Bullion Trading

  To develop Singapore as an international gold market, approved members of the Gold Exchange of Singapore are granted a concessionary 10 percent rate of tax on income derived from gold bullion transactions with persons outside Singapore, either directly or indirectly, through another member of the Gold Exchange of Singapore or through an Asian Currency Unit.

Non-Tax Incentives

Capital Assistance Scheme: A capital assistance scheme promotes the development of projects that are skill-intensive and of high technology, having established markets and a record of proven performance. The assistance available to both local and foreign companies is as follows:

- Equity participation of up to 50 percent with a buy back option during the first five years.

- Term loans up to 70 percent of the cost of fixed assets; the repayment period may range from five to ten years.

Small Industries Finance Scheme: Loans of up to S$1million are available to small and viable industries involved in manufacturing and assembly operations or in supporting services related to manufacturing.

Product Development Assistance Scheme: This is a dollar-for-dollar grant (maximum S$100,000 per project) to local companies to develop new or improve existing products/processes relating to their manufacturing activities.

Export Financing Scheme: The Monetary Authority of Singapore operates an export bills rediscounting scheme, which enables banks to rediscount certain eligible export and reexport bills within the Monetary Authority at a preferential rate. The practical effect is that the concessionary rate of interest payable to the Monetary Authority by the negotiating bank is passed on to the exporter.

Export Credit Insurance: The Export Credit Insurance Corporation of Singapore Ltd. (ECICS), in which the Government has a 50 percent shareholding, provides insurance cover to a Singapore exporter against nonpayment by the buyer caused by political or economic upheavals in the buyer's country. ECICS has recently introduced a bankers' guarantee scheme to cover short, medium and long-term credit needs of local exporters. In June 1979, ECICS became a full member of the International Union of Credit and Investment Insurers (the Berne Union).

Industrial Training: The Singapore Government pays considerable attention to industrial training. The Vocational and Industrial Training Board is the authority for the coordination of industrial training for skilled workers. The Board runs 20 industrial training institutions, the cost of which is subsidized by the government.

An industrial training grant scheme has been introduced to encourage companies to organize in-plant training programs. The grants range from S$3,000 to S$9,000 a trainee per year.

Cash grants are also available for the purchase of machinery and equipment to set up or expand in-house training facilities. Companies establishing or expanding manufacturing operations in the Republic may apply for training subsidies from the Government.

Skills Development: The Skills Development Fund was established to provide financial assistance for the promotion, development and upgrading of skills and expertise of persons in employment and the retraining of retrenched and redundant persons. Skills are defined to include industrial, technical, organizational, and commercial skills.

Three types of grants are provided, covering either 30, 50 or 70 percent of allowable costs. Priority will be given to training which results in the saving of labor and programs that directly result in higher remuneration for the workers concerned through higher productivity from training. Top priority will be given to the training and retraining of redundant or retrenched workers.

Preferential Tariffs: Singapore is a beneficiary under the Generalized System of Preferences (GSP) of GATT. Singapore-manufactured products are given preferential rates of duty when entering Australia, Canada, Japan, the EEC, the United States, Finland, New Zealand, Norway, Sweden, Switzerland, some East European countries, and the USSR. Many products are allowed duty-free entry. The major commodities exported under GSP are plywood, antibiotics, electronic calculators, cameras, transistors, projectors, refrigerator compressor motors, and miniature circuit breakers.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SOLOMON ISLANDS

INTRODUCTION:

Solomon Islands has an active policy of localization in all areas of political, social and economic life, and consequently locally owned businesses are strongly encouraged. Foreign investment is also required, however, and is encouraged by the regulatory bodies, particularly in areas of primary production, manufacturing and advanced technology, since local expertise and investment funds are not sufficient at the present time to provide adequate progress in those areas. There are strict controls over foreign investment in Solomon Islands, and the Commercial Investment Committee gives strong emphasis to the benefits likely to accrue to the economy and the social structure in considering proposals, particularly in the areas of employment, training, balance of payments and the provision of essential services. The Solomon Islands Monetary Authority must grant prior approval for all remittances from the country and also for any resident of Solomon Islands to borrow money from, or issue equity capital to, a non-resident.

OWNERSHIP RESTRICTIONS:

Foreign ownership of a freehold title to land is restricted, and normally foreign persons are only entitled to either a Fixed Term or Leasehold interest.

There are no other restrictions on foreign ownership of property and investments in Solomon Islands, other than the necessity of

gaining prior approvals from the regulatory bodies, particularly the Solomon Islands Monetary Authority and the Commercial Investment Committee.

EXCHANGE CONTROLS:

Exchange Control in Solomon Islands is administered by the Solomon Islands Monetary Authority. Prior authority is required for the following transactions:

- Remittances to non-residences.
- Crediting of accounts of non-residents, whether with a bank or in the books of an organization or individual.
- Borrowing of funds from a non-resident.
- Issuance of equity capital to a non-resident.
- Export of Solomon Islands currency in excess of S.I.$250.00.
- Dealings by residents in foreign securities.
- Export of goods where the proceeds are received earlier or later than six months before or after the date of export.

In general terms, approval will be given for all transactions representing the remittance of dividends, profits or other earnings (net of tax) to non-residents, or the repatriation of overseas capital, and also for any liabilities to non-residents for services, royalties, reimbursements and the like, provided it can be shown that they are due and payable to the non-resident overseas.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Generally the Solomon Islands Monetary Authority will approve all repatriation transactions or overseas remittance, provided that it is satisfied that the funds are properly due and payable overseas, for whatever reasons.

EMPLOYMENT RESTRICTIONS:

Permits to enter and reside must be obtained by all foreigners prior to entering Solomon Islands. Similarly, work permits must be obtained prior to entry for all persons wishing to work and intending to stay in the country for a total period in excess of 14 days in any one year.

Work permits may be renewed on expiration provided the reapplication is for the same employment, but new work permits may not be sought by foreigners who are resident in Solomon Islands. Work permits will normally only be granted after the position has been advertised both locally and overseas and the Department of Labor is satisfied that the position cannot be filled by a Solomon Islander.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

There are no subsidies or incentives which are specific to foreign investment, but provisions exist in the Income Tax Act for tax holidays for any company, which in the opinion of the Minister of Finance, would provide significant benefits to Solomon Islands. The tax holiday provides for a maximum period of 5 years exemption for income tax, although an upper limit on exempt income may be set at the time of granting the exemption. Companies benefiting from such an exemption may distribute such tax free income, and that income is exempt from tax in the hands of shareholders provided that the dividend is declared within 2 years of the date of expiration of the tax holiday period, and also provided that such dividend does not exceed the amount of issued capital of the company which has been issued for valuable consideration.

Accelerated depreciation rates may apply in respect to the expenditure on improvements to plantations, in mining, and in the cutting, extracting and processing of timber.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SOUTH AFRICA

INTRODUCTION:

South Africa actively encourages investment by foreign corporations. The economy is one of free enterprise with anti-monopoly legislation directed at protecting the public interest. The major form of regulation on foreign investment is to be found in the operation of exchange controls. These controls have been in effect for many years and are designed to restrict the outflow of capital from South Africa.

OWNERSHIP RESTRICTIONS:

Major public utilities, such as railways, harbors, television stations, postal and telephone services are owned by the government.

Foreign ownership of all forms of industrial and commercial activity is permitted subject to the approval of the exchange control authorities. Investment in new industries requires project approval by the Department of Industries.

Technology management and royalty agreements are subject to regulation through the exercise of exchange controls.

EXCHANGE CONTROLS:

The exchange control authorities administer the controls by way of guidelines which are available only to the commercial banks.

Transactions involving the use of foreign currencies may only be effected through commercial banks which are authorized to deal in foreign exchange. Prior approval of the exchange control authorities will be required for any form of foreign investment which involves the flow of share or loan capital into South Africa.

Investment which takes the form of equity share capital in ventures which introduce new know-how, expand labor intensive industry, invest in labor surplus areas, expand manufacturing capacity, enhance export promotion, or enhance import replacement may be made through the medium of the financial rand.

This form of currency trades at a substantial discount as against the commercial rand, and provides an effective incentive to foreign investment.

Other forms of investment such as loan capital may be introduced in the form of the commercial rand.

Local borrowings by foreign controlled corporations are limited by a formula which sets out the maximum permissible local borrowings as being:

$$50\% \text{ of effective capital} + \frac{\text{South African participation}}{\text{Nonresident participation}} \times 50\% \text{ effective capital}$$

Effective capital comprises issued share capital, realized capital reserves, retained earnings, foreign shareholders' loans, local shareholders' loans to the extent that they are not disproportionate to the amount of foreign shareholders' loans, and any agreed minimum balance to be retained on inter-company account with the non-resident shareholder.

Technology, management and royalty agreements must be approved by the Department of Industries, prior to their submission to the exchange control authorities. The two bodies will take into account, inter alia, the necessity of the services to be rendered and the local availability of such services.

Penalties for infringement of exchange control regulations include fines and/or imprisonment for a period of up to five years.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Capital and Loans: In general terms, capital disinvestment may only be remitted overseas in the form in which the initial investment funds were introduced: namely, financial rands for certain equity, and commercial rands for the remittances.

Income: Remittance of current profits earned by foreign investors is permitted in the form of commercial rands, subject to restrictions in the event of remittance resulting in increased local borrowings, and to tax restraints. Remittance is restricted to profits earned since January 1, 1975.

Interest service fees and royalties may be remitted in commercial rands to foreign parents subject to tax restraints.

EMPLOYMENT RESTRICTIONS:

Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis. Exchange control regulations in respect to temporary residents assigned for a period of less than three years are relaxed considerably, provided they do not undertake to place foreign assets at the

disposal of South African residents. Permanent residents are subject to the full range of exchange controls, including the repatriation to South Africa of all foreign source income.

LOCAL MATERIAL CONTENT REQUIREMENTS:

A local content program in the automobile industry requires local content by weight of 66 percent.

OTHER RESTRICTIONS:

A comprehensive tariff protection system exists in respect to local industries, and in respect to the importation of non-essential luxury goods.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

The financial rand provides an incentive to foreign investors by enabling them to acquire their investments at an effective discount.

No other incentives exist specifically for foreign investment, but certain incentives exist for investment in general, including:

- o Special tax allowances to manufacturers for new plant and building used in a process of manufacture;
- o Special tax allowances, financial assistance, and to rebates on the cost of certain utilities in respect to industries established in or transferred to specified development areas;
- o Assistance of strategic industries;
- o Special tax allowances, financial assistance and rebates to persons carrying on an export trade in respect to goods manufactured in South Africa; and

o Special tax allowances for persons who provide training to employees by way of courses or programs registered with the controlling authority.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SPAIN

INTRODUCTION:

Foreign investment is encouraged and continues to play an important part in the development of the economy. Recently, there has been a tendency to liberalize restrictions, and the level of investment is expected to increase significantly on Spain's entry into the European Economic Community (EEC).

Generally, authorization is required for all foreign investment over 25 million pesetas, and the investor is normally required to make commitments regarding exports and employment. Entities with authorized foreign participation enjoy the same standing and rights as do other Spanish entities. There are no waivers of restrictions on foreign investment from certain countries at present, but entry into the EEC will affect this.

In the past, foreign technology has made an important contribution to the building of Spain's industrial base. At present, however, royalty, technical assistance and service contracts are subject to strict control in line with efforts to reduce the net outflow of foreign exchange.

OWNERSHIP RESTRICTIONS:

Foreign direct or indirect investment in the following is restricted, being governed by special legislation:

- Local radio stations
- Motion pictures

- Newspapers and magazines
- News agencies
- Publishing houses
- Mining and hydrocarbon investigation
- Oil refineries
- Banking and insurance entities
- Air and sea transport
- Public water concessions
- Public utilities
- Government contracts
- Pharmaceutical entities
- Gaming activities

Activities directly related to national defense are prohibited. Foreign governments and State-controlled entities require special authorization to invest in Spain.

Foreign ownership in rural real estate is subject to restrictions. Technology agreements are subject to Government appraisal of the necessity of service to be rendered and local availability of technology involved. They must also be registered.

EXCHANGE CONTROLS:

Operations in foreign currency must be effected through local banks to whom powers have been delegated by the Bank of Spain. Exchange controls are strictly enforced, and some form of prior authorization or subsequent communication is normally required depending on the type of operation.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the Direction General de Transacciones Exteriores to ensure repatriation rights.

Capital, capital increases and loans normally require prior authorization and must be registered to ensure remittability.

A statutory right exists for the repatriation of dividends, but repatriation of branch profits is conditional upon the discretional authorization of the movement in the home office account, although this is normally granted.

Remittance of dividends, profits, capital gains, interest, royalties and service fees are subject to tax clearance.

EMPLOYMENT RESTRICTIONS:

Work visas and work and resident permits are a prerequisite for foreign personnel hired on either a permanent or temporary basis. The granting of work permits, with certain exceptions, depends upon the labor situation in the particular activity and the lack of a suitably qualified Spaniard.

The number of foreign workers that an employer may hire is controlled through the issuance of work permits, and in the case of certain activities, numerical limitations are also established.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Local material content is required wherever possible.

OTHER RESTRICTIONS:

Spanish foreign investment and exchange control legislation is complex, and potential foreign investors are advised to seek professional assistance to ensure that other restrictions, not specifically referred to herein, are not applicable in given circumstances--as well as to ensure general compliance.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

No specific measures exist under Spanish law to attract foreign investment, although subsidies and tax relief are granted generally to entities deemed of preferential interest or which locate in economically depressed areas.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SWEDEN

INTRODUCTION:

Sweden's support of the principles of free trade and international remittability of capital has resulted in an open attitude toward foreign enterprises in Sweden. The opinion is that foreign direct investment in Sweden has the advantage of introducing capital, employment opportunities and the knowledge of technology, marketing and administration of large and complex enterprises. Also, foreign investment may have a positive effect on the balance of payments by decreasing imports and increasing exports.

OWNERSHIP RESTRICTIONS:

The following industries are closed to private enterprise: postal services, telephone and broadcasting services; the importation and production of cigarettes and cigars; and the sale of spirits, wine and drugs.

Foreign citizens, foreign legal entities, Swedish partnersips with foreign partners, and Swedish companies with bearer shares and cooperative societies may not, without permission in each individual case, acquire real property, take out mining concessions or carry on mining activities. The same rules apply to any Swedish company with registered shares unless the company statutes restrict foreign holding of shares, directly or indirectly, to at most 20 percent of the votes.

The Press Law forbids foreigners to own or publish Swedish periodicals, for example, daily newspapers. Foreigners are not permitted to carry on credit status rating operations within Sweden. The manufacture of war materials, except on a small scale, is not permitted to foreigners. Foreign insurance companies may carry on business only through a general agent and then only after being granted special concessions.

Banking in Sweden is not open to foreign banks but these banks can, after permission from the government, carry on operations which do not include deposits and advances.

EXCHANGE CONTROLS:

Foreign exchange is subject to control, which is exercised either by the Bank of Sweden (Sveriges Riksbank) or on its behalf by specially authorized commercial banks. Foreign currency may be bought and sold only through the authorized commercial banks.

Transfer of capital for the purpose of direct investment in Sweden requires the permission of the Bank of Sweden. However, such permission is readily obtained for the establishment of a company or the acquisition of an existing enterprise.

Foreign direct investment is expected to be financed mainly from sources outside Sweden. The Bank of Sweden requires that at least 50 percent of the investment be financed by funds raised outside Sweden. Financing obtained in Sweden from Swedish sources under guarantees issued from outside Sweden requires the approval of the Bank of Sweden.

The exchange control over payments for imports, dividends, profits earned by branches of foreign corporations, loan interest, royalties, service fees and other contractual obligations to foreign recipients is delegated by the Bank of Sweden to the Swedish commercial banks, and payments of bona fide liabilities of this nature are unrestricted. It should be noted that dividends may be subject to withholding tax.

There are no registration requirements for foreign capital, apart from permission by the Bank of Sweden for transfer of capital for investment purposes in Sweden.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Repatriation of capital as well as repayment of foreign loans is subject to approval by the Bank of Sweden, but this approval is customarily granted.

The remittance of dividends is subject to withholding tax at the rate of 30 percent. However, under tax treaty provisions the withholding tax is often reduced or waived.

EMPLOYMENT RESTRICTIONS:

Before a foreign national, other than citizens of Denmark, Norway, Finland and Iceland can take up employment in Sweden, a work permit must be obtained. The application must be made outside Sweden through a Swedish embassy, legation or consulate. Employers are responsible for the reporting to the local policy authorities of details of foreigners' work permits within 24 hours after the start of their employment. Work permits are not required by foreigners married to Swedish citizens. Details of

foreigners residing in Sweden are similarly to be reported by hotels and landlords. Any foreigners who have a valid work permit may be accompanied by their families.

In event of layoffs there is no discrimination of foreigners _per se_.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Foreign companies may carry on business in Sweden through a registered branch with the permission of the Swedish government. No restrictions apply to the setting-up of representation offices where no permanent establishment for tax purposes is deemed to be constituted.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

There are no selective investment incentives directly aimed at stimulating foreign investments in Sweden. The government support falls mainly in the following categories:

- Participation in projects with high economic risks
- Loans and credit, repayable and non-repayable
- Subsidies and grants
- Technical assistance
- Export credit guarantees

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: SWITZERLAND

INTRODUCTION:

The Swiss federal and cantonal governents have little power to affect foreign investments. The economic climate does not warrant restrictions at this point in time. Switzerland does not tend to actively favor local businesses over those with foreign ownership.

OWNERSHIP RESTRICTIONS:

Acquisition or financing of real estate by non-residents and foreign-owned resident companies requires a permit by the federal government (Lex Furgler). The term real estate includes rights in real estates, shares in real estate companies, etc.

This permit is difficult to obtain and is only granted if a legitimate interest can be proven. Numerous villages do not grant permits, especially in the mountain area.

EXCHANGE CONTROLS:

Switzerland has at present no exchange control regulations for foreign investment.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Switzerland has no repatriation or remittance restrictions. Banks and other bank-like financial institutions have to obtain National Bank approval for capital exports of the equivalent of SFr 10 million or more with maturity after one year. Such approval is normally granted without any problems.

EMPLOYMENT RESTRICTIONS:

Work permits for foreign nationals are necessary and are at present difficult to obtain.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Basically none; however, the government may require, on a case-by-case basis, that goods purchased abroad by the government be partly manufactured or assembled within Switzerland.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENTS:

Certain cantons grant tax incentives for new investments in remote areas. These are agreed upon with the respective authorities on a case-by-case basis.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: TAIWAN

INTRODUCTION:

Over recent years, the government of Taiwan has developed plans to guide and control the economic growth of the country with current emphasis on capital-intensive and technology-intensive industries. The government places high priority on attracting capital inflow and the transfer of technological know-how to Taiwan. The main categories of investment open to foreigners are (1) productive enterprises needed in Taiwan, (2) enterprises which have export markets, (3) enterprises which foster the development and improvement of important industrial, mining and communicative facilities, and (4) enterprises which are conducive to the economic and social development of Taiwan.

OWNERSHIP RESTRICTIONS:

Private industry is excluded from the following industries: armaments/munitions, tobacco and wine, public utilities, and petroleum. In addition, inland transportation services are closed to foreign investment.

EXCHANGE CONTROLS:

Generally, all transactions involving foreign currencies require a license or prior permission.

Foreign currency earnings remittances in excess of U.S.$5,000 must be deposited in a local bank foreign currency deposit account before conversion into New Taiwan dollars. Such deposits can be used for foreign commercial transactions approved by the Central Bank, or sold to designated banks.

Foreign exchange remittances of all types require government approval.

Exchange controls tend to be more liberal in capital/technology intensive investment projects.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Only Foreign Investment Approved (FIA) companies are allowed to repatriate the original capital and subsequent profits.

Repatriation of original capital and subsequent approved additional capital is usually allowed at the rate of 20 percent per annum beginning two years after completion of the approved investment plan. Profits in the form of dividends may be repatriated at any time.

Loan and technology investments may be repatriated according to the approved timetable in the original application.

Additional restrictions apply to repatriation of dividends/gains from purchased securities.

EMPLOYMENT RESTRICTIONS:

Foreign personnel who are to be employed for periods in excess of 180 days must obtain a work permit in order to be issued an entry

visa approved initially by the Ministry of Economic Affairs and then finally by the Ministry of Foreign Affairs.

As a general rule, work permits will only be issued for general managerial and/or technical personnel of non-FIA companies, but not for managerial staff. FIA companies may have expatriate managerial staff provided this was included in the application for approval.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Restrictions are imposed on certain imports for political and economic reasons. No imports are allowed from Communist countries, and the following guidelines are used in determining whether certain imports are to be controlled:

- Where the quality of similar local products is comparable to foreign products;
- Where local demand can be met by local production;
- Where the price of the imported product exceeds 95 percent of the local product; and
- Where imported raw materials exceed 70 percent of total production cost of local product.

OTHER RESTRICTIONS:

There are substantial formal procedures to be gone through by a foreign company wishing to make investments which carry the right of repatriation of original capital and profits and thus to become a Foreign Investment Approved (FIA) company.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Taiwan offers a five-year tax holiday to companies investing in specified industries, and reduced rates of income tax to all enterprises in, again, specified industries.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: TRINIDAD AND TOBAGO

INTRODUCTION:

Trinidad and Tobago welcomes foreign investment, particularly where it introduces skills and expertise not readily available locally. The foreign investor would be expected to provide training facilities for nationals who would, in due course, be expected to replace expatriate personnel. A work permit is required to enable an expatriate to work in Trinidad and Tobago. A foreign investor in Trinidad and Tobago is not allowed to hold shares in a local company without obtaining permission from the Government. The Government will insist on local control before granting a license to hold shares to a foreign investor. The Government regards joint ventures between local and foreign firms, Government and foreign firms or a combination of Government, local and foreign firms, as the most desirable form of direct foreign investment.

OWNERSHIP RESTRICTIONS:

Foreign ownership is generally restricted to minority participation. An alien's license must be obtained to hold shares.

Foreign investors are not normally allowed to acquire freehold property. Government permission is required.

EXCHANGE CONTROLS:

Operations in foreign currency may be effected only through banks authorized to deal in exchange.

Prior approval of the Central Bank of Trinidad and Tobago is required for transactions involving foreign currency.

REPATRIATION OR REMITTANCE RESTRICTIONS:

Investments must be registered with the Central Bank to ensure repatriation rights.

Capital, loans and technology agreements must be approved by, and registered with, the Central Bank to ensure remittance rights.

Royalty agreements, agreements to provide management services or technical services, and any other agreements or contracts must be approved by and registered with the Central Bank to ensure remittance rights.

The remittance of funds arising as a result of the appreciation in value of assets will normally be phased in over a period of years.

Profits, dividends, interest and other current payments arising from foreign investment are presently freely remittable abroad provided the Central Bank is satisfied that all tax liabilities have been settled.

EMPLOYMENT RESTRICTIONS:

Work permits are necessary for foreign personnel hired on either a permanent or temporary basis. Work permits are normally only issued when qualified nationals are unavailable.

LOCAL MATERIAL CONTENT REQUIREMENTS:

The Government may in certain circumstances require the use of locally produced items in certain enterprises.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Under the provisions of the Fiscal Incentives Act of 1979, an approved enterprise may be granted tax concessions in respect to the manufacture of approved products.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: UNITED KINGDOM

INTRODUCTION:

Successive British Governments have welcomed and encouraged foreign investment in the U.K., which is seen as contributing to the development of the economy, contributing new technology, skills, ideas and management techniques, and providing employment. This policy continues and takes the following principal forms:

- The enactment of laws and regulations governing business activities which do not discriminate against foreign-controlled enterprises;
- The availability to domestic and foreign-controlled investors alike, and irrespective of industry or location, of significant tax incentives, mainly accelerated depreciation allowances (up to 100 percent for plant and machinery in the year of acquisition) and stock relief;
- The availability of further financial incentives, again regardless of ownership, on a selective basis for manufacturing projects throughout the country and automatically as development grants on capital expenditure in areas with declining traditional industries; and
- The abolition in 1979 of all forms of exchange control.

The U.K. also offers foreign investors the benefits (mainly reduced tariffs and access to regional development and other funds) of membership in the EEC and the European Free Trade Association (EFTA).

Labor's attitude towards foreign investment is also generally favorable, especially where it is seen as creating increased employment opportunities.

The Government and a number of other institutions (e.g., the nationalized industries) are from time to time pressured to "buy British," but this is not on a formal basis and usually emanates from employees and special interest groups.

OWNERSHIP RESTRICTIONS:

Except in certain sectors of the defense industry, there are no U.K. restrictions on investment in the private sector. Major industries which are effectively Government controlled and generally closed to private enterprise include coal mining, bulk crude steel manufacture, shipbuilding and repairing, aircraft and aero-engine manufacture, electricity generation and transmission for public consumption, natural gas distribution to final consumers, and railway transportation and telecommunications (but not the manufacture of telecommunications equipment). However, the present Government is seeking ways of "privatizing" certain parts of these industries.

The attitude of the Government towards monopoly is essentially neutral in that regulations restricting monopoly situations are enforced only when the monopoly is shown to be against the public interest. Under the Fair Trading Act of 1973, a monopoly situation is defined as one in which a single firm or group holds one-quarter of the supply of goods or services in a particular category. Where such a situation exists or is contemplated, the Director of Fair Trading can refer the situation to the Monopolies Commission for investigation.

In the case of mergers or proposed mergers, a reference may be made to the Monopolies Commission either on the 25 percent market share criterion or on grounds of size of transaction. In the latter instance, the criterion is met if the assets taken over, or to be taken over, exceed $15 million. There are special regulations governing the acquisition of newspapers.

There are no special rules or requirements regarding acquisition by foreign entities of U.K. publicly held enterprises. However, mergers affecting companies listed on the Stock Exchange are expected to be conducted in accordance with the City Code on Takeovers and Mergers.

EXCHANGE CONTROLS:

None

REPATRIATION OR REMITTANCE RESTRICTIONS:

As indicated in the Introduction, all forms of exchange control in the U.K. were abolished in 1979.

EMPLOYMENT RESTRICTIONS:

Legislation: Recent legislation, in particular the Employment Protection Consolidation Act of 1978, provides considerable safeguards for employees in their terms of employment and working conditions. The legislation, *inter alia*, requires employers to give employees written information on their terms and conditions of employment, prescribes minimum periods of notice of termination of employment, provides for "redundancy" payments to employees who are dismissed when surplus to requirements, lays

down rules to be followed when employees are held by their employers to be guilty of misconduct or incompetence, and gives women employees protection from dismissal because of pregnancy.

The employment provisions of the Sex Discrimination Act of 1975 make sex discrimination unlawful in employment, training and related matters, and the Race Relations Act of 1976 makes unlawful discrimination on grounds of color, race, nationality or ethnic or national origin in employment, training and related matters.

It is also likely that in the future, increased government attention will be focused on employers' policies towards the disabled.

Trade Unions: Agreements reached between employers and unions (which represent slightly under half the total workforce) over pay and conditions are not binding in law. Since 1907, unions have enjoyed a wide degree of legal immunity in respect to industrial action carried out in contemplation of, or in furtherance of, a trade dispute.

Foreign Nationals: Nationals of the EEC do not require permits to enter the country to look for or to take up a job already arranged, although a residence permit must be obtained from the Home Office if they wish to remain for longer than six months.

A person who is a national of one of the Commonwealth countries or a foreign country outside the EEC may not enter, unless he is the holder of a current work permit issued by the Department of Employment.

LOCAL MATERIAL CONTENT REQUIREMENTS:

There are no legal requirements which come under this heading. However, from time to time, pressures are brought to bear by organized labor and special interest groups, especially on the Government, nationalized industries and local authorities to "buy British."

OTHER RESTRICTIONS:

Imports: There are currently no general restrictions on imports. However, cetain categories of goods (e.g., textiles) are subject to "surveillance licenses." Such licenses are granted freely to importers but imply that special attention is being paid to the level of imports. Where the level of imports is felt to have reached proportions which are harmful to industry, quota restrictions may be applied.

Certain other goods, principally, tobacco, hydrocarbon oils and alcoholic drinks are not subject to import restrictions but are subject to import duties.

Exports: The major types of exports upon which restrictions are placed are certain types of strategic goods and materials, weapons of war, atomic energy materials, diamonds, live animals, endangered species, antiques, and EEC common agricultural policy products.

Miscellaneous: Regulations regarding matters such as labeling, additives and contaminants are administered by the Ministry of Agriculture, Fisheries and Food.

The Control of Pollution Act of 1974 contains regulations covering the disposal of waste, noise levels and atmospheric and water pollution. The regulations are administered by the Department of the Environment.

Banking and Insurance: Under the 1979 Banking Act, all institutions taking deposits from the public must be authorized to do so by the Bank of England. Two forms of such authority are available:

- Recognition as a bank
- Recognition as a licensed deposit-taker only.

Both types of institution are required to contribute to a deposit protection scheme.

The operations of insurance companies are subject to the special regulations of the Insurance Companies Acts of 1974 and 1981 and numerous statutory instruments.

INCENTIVES TO FOREIGN INVESTMENT:

The principal incentives to invest or expand, which are available nationally and as of right, operate through the tax system. They are mainly in the form of accelerated depreciation allowances (up to 100 percent in the year of acquisition for plant and machinery) and stock relief.

The government also provides assistance on a selective basis in the form of grants to ensure that manufacturing investment projects in the national interest (which may be defined in terms of an increase in net U.K. output or of substantially improved

productivity) go forward anywhere in the U.K. Internationally mobile projects are attracted by individually tailored assistance packages.

The most generous incentives apply in "assisted areas," which are those suffering from declining traditional industries and/or high unemployment. In addition to eligibility for selective assistance, capital investment in such areas also attracts automatic regional development grants up to 22 percent, which are non-taxable and do not reduce the cost of assets for tax purposes. In addition, loans at favorable rates of interest for up to 50 percent of the fixed capital cost of manufacturing projects are available from the European Investment Bank and the European Coal and Steel Community. The Exchange Risk Guarantee scheme provides cover against the exchange risk on such loans, if desired. Moreover, Government built factories are available for sale or rental, frequently with rent free periods, and the in-plant training scheme can provide 80 percent of eligible training costs for manufacturing projects. Offices, research and development units and service industries may qualify for job related grants and removal expenses.

The foregoing regional industrial incentives are available in England, Scotland and Wales. Generous but different schemes operate in Northern Ireland.

Finally, the Government either directly or indirectly administers schemes which provide nationally available financial incentives to (a) enterprises engaged in specific industries (e.g., micro-electronics); (b) exporters, mainly in the form of grants towards promotional expenditure and the provision of comprehensive credit insurance covering more than a third of the country's export trade; and (c) employers who provide work experience and training opportunities to school dropouts and other unemployed persons.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: URUGUAY

INTRODUCTION:

Uruguay's Government policy is favorable in regard to foreign investment. Foreign investors may invest within the framework of the Foreign Investment Law in force since March 28, 1974. Conversely, the authorities have the option to grant or deny protection to the investor within the terms of the law, taking into account national interest and economic development programs. The foreign investor has, however, the option either to come within or to remain outside the framework of the Foreign Investment Law.

There is no tendency to favor local businesses over those with foreign ownership; neither are there restrictions on foreign investments by companies from certain countries.

OWNERSHIP RESTRICTIONS:

At present, the following activities are, in effect, closed to private ownership and consequently to foreign investors because they are wholly in the public sector: public water services and drainage works, railroads, alcohol and petroleum refineries, electricity and telephone, mail, port facilities, insurance (except for existing companies and for certain specific risks), telegraph services, and issuance of mortgage bonds.

EXCHANGE CONTROLS:

Effective October 1974 the sale of foreign exchange for most purposes, which was allowed only to banking houses and limited in amount and period, was freed. Now a free exchange market operates on the basis of fluctuating exchange rates determined by supply and demand. The Central Bank, however, is monitoring the exchange rate by announcing its buying and selling exchange rates for future short-term periods.

REPATRIATION OR REMITTANCE RESTRICTIONS:

There are no restrictions in this respect; remittance of foreign currency is at present completely free even if the investment has not been made within the terms of the Foreign Investment Law.

Investment under the Foreign Investment Law carries in addition guarantees as to the convertibility and remittance of profits and the reimbursement of invested capital. However, within the investment permanence term fixed by the contract required to be signed with the Government (generally ten years) only profits can be remitted. The invested capital cannot be repatriated until the term expires.

EMPLOYMENT RESTRICTIONS:

Foreigners can work during 180 days without any specific authorization.

Once this term expires an authorization for temporary residence is required. The status of temporary residence can be maintained for not more than two years, after which an authorization for permanent residence is mandatory.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

Registration of foreign capital under the Foreign Investment Law is the responsibility of the Central Bank. A company registered under the Foreign Investment Law with more than 50 percent of the voting rights relating to capital held abroad is subject to several local and foreign credit restrictions.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

If the foreign company is declared to be of "national interest" under the rules of the Industrial Promotion Law, also enacted on March 28, 1974, this qualifies the company to obtain bank loans and entitles it to tax exemptions to the extent allowed by the Authorities.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: VENEZUELA

INTRODUCTION:

Venezuela is a member of the Andean Pact and subscribes to the Pact's restrictive rules regarding new foreign investment. In general any new enterprises must be at least 51 percent Venezuelan-owned, although they may be 100 percent foreign-owned in the case of companies rendering services to the State-owned mining and hydrocarbons industries. Also, in certain cases of new investment considered beneficial for the nation a company can initially be wholly owned by foreign investors, provided they agree to transfer the shareholdings to 51 percent Venezuelan within a limited number of years. There are also a number of restrictions involving contracts for importation of technology and on royalties or technical fees which may be paid to affiliates abroad.

OWNERSHIP RESTRICTIONS:

Activities reserved to companies owned over 80 percent by national investors:

- Internal commercialization of goods;
- Public services, i.e. mail, telephone, telecommunications, potable water, drainage, electricity, garbage collection, security;
- Communication, i.e. TV and radio broadcasting, Spanish newspapers and magazines, internal transport, publicity; and
- Professional services requiring professionals governed by local laws.

New investments must generally be at least 51 percent Venezuelan-owned (except for companies rendering services to the state-owned mining and hydrocarbons sectors), and approval by the Superintendency of Foreign Investments (SIEX) is required for all new foreign investment.

EXCHANGE CONTROLS:

None

REPATRIATION OR REMITTANCE RESTRICTIONS:

All foreign investments must be registered with SIEX.

Annual profits can be repatriated abroad up to 20 percent (net after 20 percent withholding tax) of the registered capital base approved by SIEX. Excess earnings may not be remitted, but can be reinvested in the company or used to purchase certain local securities. The registered capital base may be increased by freezing profits in a reinvestment reserve up to 7 percent annually of the base.

Upon sale or liquidation of the investment all proceeds and retained earnings may be freely remitted after payment of appropriate taxes.

Loans and technology agreements must be registered in order to have remittance rights and obtain tax deductions. No royalties or technical assistance payments may be made to affiliated companies abroad.

EMPLOYMENT RESTRICTIONS:

Entry visas may require approval of the Labor Ministry or a local professional body in the field in which the prospective candidate wishes to work.

Seventy-five percent of the employment in each company (in number, in total remuneration paid, and by location in the country) must be Venezuelan. Exemptions may be made in justified cases requiring skills not available in Venezuela.

LOCAL MATERIAL REQUIREMENTS:

This can vary depending on the industry.

OTHER RESTRICTIONS:

Companies controlled by foreign investors cannot borrow more than 40 percent of their capital from local banks, and then not on a long-term basis. Furthermore, certain ratios of equity and foreign debt must be maintained while indebted to local banks.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

There are no subsidies or incentives specifically directed to foreign investment.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: WESTERN SAMOA

INTRODUCTION:

Western Samoa actively encourages foreign entities to set up local manufacturing operations. This policy is part of an overall plan to increase exports and/or reduce imports through import substitution and also to provide employment for its nationals.

OWNERSHIP RESTRICTIONS:

Foreign ownership of freehold land is restricted and requires approval of the Head of State.

Foreign ownership of companies may be restricted to 50 percent in certain types of industries.

Foreign ownership of rural customary land is prohibited.

EXCHANGE CONTROLS AND REMITTANCE RESTRICTIONS:

There is strict control over the allocation of foreign exchange for all forms of remittance overseas.

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EMPLOYMENT RESTRICTIONS:

Work permits are required for foreign personnel hired on either a permanent or temporary basis (over 30 days). Permits are subject to periodical reviews.

LOCAL MATERIAL CONTENT REQUIREMENTS:

None

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

Western Samoa provides up to a 5 year tax holiday to approved enterprises. Concessional rates of duty are also available to approved enterprises.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: ZAMBIA

INTRODUCTION:

Humanism in Zambia is a political philosophy which endeavors to devise a social, political and economic order which will create an egalitarian society and the avoidance of exploitation of many by man. To achieve this, after many years of colonial rule, the State has stepped in to control and guide the industrial, agricultural and other economic activities of the country with the ultimate goal of the creation of a socialist economy. More than 80 percent of the industrial activity is controlled by the Zambia Industrial and Mining Company Limited (ZIMCO) which is funded by the Government. Under the umbrella of Zimco are the associated companies and subsidiaries (called Parastatals) which are divided into the following categories: (a) Mining; (b) Industrial; (c) Agriculture Rural Development; (d) Finance; (e) Trading; (f) Transport; (g) Energy; (h) Hotels and Tourism; and (i) others - which includes the Posts and Telecommunication and the Zambia National Building Society. In this environment private enterprise plays a small role, and until recently little encouragement has been given for this growth. Further, strict exchange control regulations and lack of foreign exchange have added to the problems of the private sector.

However in his budget speech this year in January 1981, the Hon. Minister of Finance gave indications that encouragement would be given to private enterprise and to the entry of foreign capital into the country. Foreign capital will be welcomed to Zambia

provided it is made available without strings to the State or to any other institution, and also provided it does not go against the principles of humanism. This change of attitude is perhaps due to the poor performance of the Parastatals, whose contribution to the growth of the economy of the country has been negligible. They are running huge losses and have become increasingly dependant on the Government to pull them out of their financial difficulties. The Government has spent large sums as subsidies to these Parastatals which have become a huge drain on the national coffers. There are allegations of waste, inefficiency, bad management, bad planning, etc. Whatever the cause, the Parastatals have become a liability to the country.

In view of the above and the severe shortage of foreign exchange, there are strict exchange and repatriation controls to limit the outflow of capital. The industries that have been set up are heavily dependant on the importation of raw materials and other essential production inputs, and as soon as there is a shortage of foreign exchange they are badly affected. Incentives to private enterprise have been offered in the 1981 budget proposals, and foreign participation is welcomed in the industrial and agricultural sectors.

It is hoped that these incentives, which are embodied in the amendment to the Industrial Development Act of 1977, will encourage private enterprise and foreign participation and increase the industrial growth of the country.

<u>OWNERSHIP RESTRICTIONS</u>:

The Radio and TV station is a wholly owned subsidiary of Zimco. Of the two daily newspapers, one is fully owned by the Government and the other is in the process of being taken over.

The national airline is owned by the State. The Zambia Railways and the United Bus Company are both State owned. The Zambia National Commercial Bank is also a wholly owned subsidiary of Zimco. The foreign banks which were in operation before independence are 50 percent owned by the government. All insurance is undertaken by the Zambia State Insurance Corporation, which took over all operations of foreign insurance companies.

Land, is the "property of the State," and under the Land (Conversion of Titles) Act of 1975 "all land in Zambia vests absolutely in the President who holds it on behalf of the people of Zambia." The State grants leases for one hundred years which can be renewed for further periods of hundred years subject to certain conditions laid down in the Act. However there are government owned farms, large private farms run by commercial farmers who are Zambian citizens of foreign origin, and small holdings.

Under the provisions of the Industrial Development Act of 1977, every technology agreement must be registered with and approved by the Ministry of Trade & Commerce; and there are certain conditions stipulated in the Act which have to be fulfilled prior to approval. These conditions govern the nature of the technical assistance, the fees and royalties payable, and the supplies of goods and material required for such assistance, etc.

EXCHANGE CONTROLS:

The Exchange Control Act of 1965 has established strict control regulations covering all areas connected with foreign exchange.

Under this Act all operations in foreign currency must be approved by the Bank of Zambia - the Central Bank. The actual foreign exchange operations are carried out only by the Commercial banks.

Except with the permission of the Minister no person may buy any monies, borrow any foreign currency, sell any money or make any payment outside Zambia. All such applications have to be made through the respective commercial banks to the Bank of Zambia, which will approve them after scrutinizing the agreements.

The penalties for infringement of exchange control regulations are heavy, e.g., a fine of one hundred thousand kwacha ($113,636), imprisonment for a period of 2 years, or both.

In cases where the offense involves gold, currency, securities or goods the fine may be larger and the goods confiscated. If the offender is a corporate entity there is no limit to the fine imposed.

REPATRIATION OR REMITTANCES RESTRICTIONS:

Due to the drastic drop in the price of copper, the main earner of foreign exchange, Zambia has experienced very severe exchange problems since 1974. There is considerable delay in the repatriation of capital and the remittance of profits which must be paid into the "Pipeline."

This "Pipeline" is a suspense account in the Commercial Banks wherein are held all payments due to foreign exporters who supply Zambia. Also held are debts for services, royalties, loans, dividends, profits, and other sundry items such as personal remittances of expatriate employees. The Kwacha equivalent of

all payments held in the "Pipeline" is in turn deposited by the Commercial Banks with the Bank of Zambia.

As foreign exchange becomes available for the purpose, the Bank of Zambia allocates funds to the Commercial Banks. These funds are applied to the "Pipeline" accounts in the Commercial Banks on a "first in first out" basis.

The present arrears in the "Pipeline" range from about 12 to 30 months depending on the category of the debt. The arrears are about 20 months for import payments and about 30 months for profit and dividend remittance. Education and medical needs are given top priority. The Zambian importer bears the risk in the event of changes in exchange rates. The Bank of Zambia permits interest to be paid on debts in the "Pipeline" at 2 percent above the bank rate in the country of destination of the funds.

In view of the above there are certain conditions that have to be fulfilled when an application is made to the Bank of Zambia for the repatriation of capital and remittance of profits:

- Foreign investments, loans, etc. must be registered with the Bank of Zambia to ensure repatriation rights.
- All technology agreements must be registered with the Bank of Zambia in addition to registering with the Ministry of Commerce and Trade to ensure remittances of fees and royalties.
- Profits may be remitted to foreign shareholders in the form of dividends on which a withholding tax of 20 percent is levied. This rate of tax is restricted if there is a Double Tax Agreement with the country concerned according to conditions therein. The maximum remittable dividend is the lower of 16 percent of the fully paid up share capital or 50 percent of the after tax profits.

- Any capital increase must obtain prior approval of the Bank of Zambia to whom the company applies through the respective commercial bank. Branches of foreign companies are allowed to remit 50 percent of their after tax profits.

- Foreign capital can be repatriated to its country of origin provided it has been registered with the Bank of Zambia at the time it was brought to the country. It is not clear whether the share capital created by the capitalization of reserves can be taken out of the country, but it does broaden the base for profit remittance in the form of dividends.

- Royalties, interest, management and consultant fees can be remitted outside Zambia, subject to a withholding tax of 30 percent of the gross amount. The withholding tax can be reduced by the conditions laid down in the appropriate Double Tax Agreements between the respective countries.

- All royalty, management and consultant agreements must be registered with the Bank of Zambia and approval obtained as a prior condition to remittance rights. these agreements are scrutinized both by the Bank of Zambia and the Ministry of Trade & Commerce before approval is granted.

- All expatriate employees on a two or more year contract are entitled to remit overseas one third of their gross salary subject to a maximum of K600 ($682) per month.

- Any gratuity at the end of the contract can also be remitted. There is no delay in the monthly remittance, but gratuities are currently held up in the "Pipeline" for some 10 months.

EMPLOYMENT RESTRICTIONS:

All non-Zambian employees must obtain work permits. The application must be made to the Chief Immigration Officer and a copy sent to the Secretary, Zambianisation Committee, where the application is checked and a permit issued for 2 to 3 years if it is established that no Zambian is available to do the work for

which a permit is required. The fee is K100 and every extension K20. Only after a work permit has been issued can the employee enter the country.

All contracts signed with the employee must be sent to the Bank of Zambia for approval, thereby obtaining the right to remit monthly a third of the gross salary.

A Selective Employment Tax (SET) of 20 percent of the gross annual emoluments of employees who are on work permits must be paid by the employer to the Government. This is a disincentive to the employment of non-Zambians. Employees in Government and other bodies approved by the Government are exempted. Effective April 1, 1980, SET will not be allowed as a deduction for income tax purposes.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Where there is local production of machinery there is no requirement that component parts be manufactured locally. It is, however, the policy of the Government to encourage manufacturers to do so, especially in the one motor vehicle assembly plant. In the incentives to the industrial sector, as proposed on the Industrial Development Act 1977, one of the main conditions for the recognition of a "priority enterprise" is the maximum use of domestic raw materials and the employment of local labor and domestic skills.

OTHER RESTRICTIONS:

None

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

In the Budget proposals of January 1981 the Hon. Minister of Finance has offered the incentives stipulated below. The Bill giving these proposals legal status is in the process of being presented to Parliament.

- A "priority enterprise" as defined in the Industrial Development Act 1977 will be exempt from income tax initially for five years, after which a further period of relief will be considered, depending on its performances and fulfillment of the conditions which in the first place gave it "priority enterprise" status.

- Dividends declared and distributed or distributable during the tax relief period will be exempt from tax in the hands of the recipients.

- Capital expenditure incurred during the tax relief period by an approved "priorty enterprise" on any asset which continues to be used for the purpose of that same trade or business after the end of the tax relief period shall be deemed, for depreciation purposes, to have been incurred on the day following that on which the tax relief period ends.

- Losses incurred by a "priority enterprise" in the course of carrying out its trade or business during the tax relief period shall be deemed as having been incurred, for income tax purposes, in the charge year following that in which the tax relief ends.

- The "priority enterprise" will be exempt from selective employment tax during the period of the tax holiday.

- There is also provision for accelerated depreciation on assets used by a "priority enterprise," but details are not available at the moment.

- An initial investment allowance of about 15 percent of the cost of the machinery and plant used by "priority enterprises" may be allowed over and above the normal depreciation.

- There will be a suspension of import duties on certain items like bulldozers and diesel tractor engines, including spares, etc.

- There will be tax relief for expenditure on scientific research and capital expenditure incurred in the provision of such scientific research facilities.

- There will be a tax relief of 10 percent of the net profit allowed in computing the taxable income for a period of five years of new industries opened in rural areas, including hotels, lodges and motels.

INCENTIVES - AGRICULTURAL SECTOR

- Companies carrying on farming activities will be taxed at a flat rate of 25 percent.

- Individuals who receive farming income will be taxed at the normal rates for individuals, but the maximum rate will be only 25 percent.

- There is provision for accelerated depreciation at the rate of 50 percent of the cost on a straight line basis of farming machinery, equipment and implements.

- A development allowance of 10 percent of the expenditure incurred in planting tea, coffee, banana and other allied plants will be allowed as a deduction and if not utilized may be carried forward for a maximum of three years.

- Expatriate (non-Zambian) farmers are allowed to remit overseas 12 1/2 percent of their annual profits provided certain conditions laid down by the Bank of Zambia have been fulfilled.

- Farmers are given a bonus of a foreign remittance of $0.63 on each extra 90 k.g. bag above 5000 bags of maize, 2000 bags of wheat and 1000 bags of soya beans delivered to marketing organizations.

NON-TAX INVESTMENT RESTRICTIONS

COUNTRY: ZIMBABWE

INTRODUCTION:

Zimbabwe's new government took office in April 1980, and its attitude to foreign investment is still being evolved. General policy is to welcome foreign investment in new enterprises, but foreign investors are expected to provide for domestic equity participation within a reasonable period of time, if not from the outset. Strict foreign exchange, import, and repatriation controls exist to limit the outflow of foreign currency. New import permits are more readily obtained by emergent local businessmen, but all applications are considered on their merit. The information supplied below is subject to change at short notice and on a retrospective basis.

OWNERSHIP RESTRICTIONS:

Existing businesses - An injection of additional foreign capital or technology will be welcomed if it means an increase in productivity and an improvement in the end product. As a general rule, the absolute amount of existing domestic participation in a domestic enterprise should not be diluted by sale to foreign interests; nor must an existing domestic control level of equity holding be allowed to pass to foreign investors.

New businesses - Foreign investment will be particularly welcomed in the following situations:

- In Labor intensive enterprises;
- Where specific technology of the investor will make an additional net contribution to the economy, including the training of Zimbabweans;
- On a joint venture basis with immediate domestic or state equity participation;
- Where activities generate exports; and
- In rural areas.

Particular industries - Quasi-government industries at present comprise airways, railways, posts and telecommunications, agricultural marketing, and water and electricity authorities. A mineral marketing corporation is likely to be established by the Government before the end of 1981.

Generally - Exchange control approval is required before foreign investments or agreements are made, and in addition the consent of the foreign investment committee is also required for such investments.

EXCHANGE CONTROLS:

Very strict exchange control regulations apply to all foreign currency transactions and foreign controlled corporate entities operating in Zimbabwe.

Prior approval of the Reserve Bank of Zimbabwe is required for all foreign investment inwards and foreign expenditure including commitments involving other currencies--in fact all foreign currency transactions.

Intercorporate and interaffiliate current accounts involving foreign currencies are not permitted without the prior approval of the Reserve Bank of Zimbabwe.

REPATRIATION OR REMITTANCE RESTRICTIONS:

New investments or capital increases require the prior approval of the Reserve Bank of Zimbabwe.

Where "venture capital" status is obtained for new capital introduced through normal banking channels, it may be repatriated after a period of two years, less the income remitted in that period, but including any profit on realization through the medium of Government 4 percent bonds which allows repayment to be phased over 6 years, subject to the bonds being available at the time.

Disinvestment by foreign companies without "venture capital" status currently gives rise to the proceeds being restricted within Zimbabwe, pending a Government policy decision in relation thereto.

Dividends and branch profits may only be remitted to the extent of 50 percent of after tax normal profits subject to exchange control approval. Withholding tax is 20 percent on dividends and 10 percent on interest to be deducted at source and paid over to the Government within 30 days of declaration.

Remittance of royalties and service fees is subject to prior approval of agreements by exchange control and then limited to specific percentages, if approved.

EMPLOYMENT RESTRICTIONS:

Work permits or residence permits are required for foreign personnel hired on either a temporary or a permanent basis. An important criterion for their issuance is the creation of additional local employment opportunities.

Generally, work permits are for limited periods, are non-renewable and are only issued when foreign personnel train Zimbabweans during their stay. Residence permits, once approved, are without time limits.

Expatriate terms for foreign personnel are either discouraged or not allowed, depending upon the industry.

LOCAL MATERIAL CONTENT REQUIREMENTS:

Import permits will not be obtainable where goods are available locally, even if the local goods are more expensive.

OTHER RESTRICTIONS:

Local borrowings are normally restricted to 30 percent of equity capital introduced, but exchange controls do make exceptions and each case is considered on its merits.

Project approval from the Ministry of Industry is required for new or additional industries in Zimbabwe, before the business may be set up.

SUBSIDIES AND OTHER INCENTIVES TO FOREIGN INVESTMENT:

No special or preferential taxation, exchange control or import control benefits will be granted as a condition of state participation in any enterprise.

Certain rural growth areas, yet to be announced, will have tax incentives for all investors whether local or foreign for an initial period of 5 years from April 1, 1981. The incentive will be 100 percent special allowance and 15 percent investment allowance on capital expenditure in the year of acquisition.

Prepared Statement of Motor Vehicle Manufacturers Association of the United States, Inc., Washington, D.C.

The issue of foreign trade-related performance requirements and the development of an appropriate United States policy response has attracted a good deal of attention in recent months. The Reagan Administration's July 8 policy statement on trade and the oversight hearings of this committee certainly indicate a concern over the implications for the United States economy of these performance requirements.

While some analysts define the issue in broad, non-sector specific terms, others have tended to concentrate their attention on foreign automotive trade-related requirements, with special reference to the policies of developing countries. This emphasis on the motor vehicle industry has led MVMA member companies to review their own experience with automotive trade and investment policies of nations around the world. This experience is extensive; our member companies [1] have been manufacturing abroad and trading in the international market for most of this century. The following comments are offered in the hope of contributing to a better understanding of these complex issues.

Before discussing automotive experience in detail, however, it would be useful to outline the general range of national programs that influence both trade and investment decisions, the apparent incidence of these programs in countries outside the United States, and which sectors they appear to influence. This overview will help to place in perspective the position of the automotive industry overseas with respect to national trade and investment related policies.

With regard to specific national policies that influence trade and investment, much attention recently has focused on trade-related performance requirements that fall into two general categories: (1) export requirements, and (2) local content requirements. Export performance requirements usually are commitments imposed on an investing firm to export a certain percentage of production or to offset their imports with exports, while local content requirements generally specify that a given proportion of the final output must be obtained from local sources or produced locally by the foreign investor.

These performance requirements generally occur in combination with other government policies that limit imports of similar products into the host country. Such import limiting policies might include high—often prohibitive—tariffs, various types of tax and other non-tariff barriers that discriminate against imports, limitations on foreign exchange available for imports, or other forms of restrictions such as quotas. In order to stimulate domestic production of the import-limited product, tariff concessions which often reduce or waive the high rates imposed on selected imports are given to firms that make the desired investments in local production. Other industrial policies may provide for tax rebates applicable variously to local sales, or to export sales of items produced in the host country, or to the investment required to accomplish local production. Additional forms of industrial policy may include modification or waiver of limitations on foreign ownership, more liberal terms for remittance of dividends, concessionary credit facilities, duty free importation of machinery and equipment etc. Moreover, many of these national policies can be informal or shaped to fit the circumstances of individual investment programs approved by the host government.

As to the incidence of such national programs, the recently published benchmark survey [2] by the Department of Commerce provides some useful data on the frequency and type of programs encountered by U.S. firms with affiliates operating overseas in 1977. There are limitations to the data, of course; for example, the survey applies only to one year for those countries and sectors where U.S. affiliates had chosen to operate. Nevertheless, the survey indicates where such programs are prevalent and which sectors appear to be affected.

The frequency with which U.S. affiliates reported incidents of trade-related industrial policies in developed and developing countries is summarized in Exhibit I. Although incidence of performance requirements tends to be higher in developing countries than in developed countries, the proportions are low for both groups. Moreover, the range in frequency of other trade-related industrial policies of the developed countries rivals those of developing countries.

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[1] MVMA members include 11 U.S. automobile, truck and bus manufacturers producing more than 99 percent of all domestic motor vehicles. MVMA members include: American Motors Corporation; Checker Motors Corporation; Chrysler Corporation; Ford Motor Company; Freightliner Corporation; General Motors Corporation; International Harvester Company; Mack Trucks, Inc., PACCAR Inc.; Volkswagen of America, Inc.; and White Motor Corporation.

[2] U.S. Direct Investment Abroad, 1977, U.S. Department of Commerce, April 1981.

The survey includes affiliates in mining, petroleum, trade, finance and services, as well as manufacturing. The proportion of performance requirements in manufacturing tends to be higher than average. Within the manufacturing sector, the pattern of variation for transportation equipment—predominantly motor vehicles—is similar to other major sectors such as electrical equipment, food processing, chemicals, and nonelectrical machinery (Exhibit II). Transportation equipment does appear to be somewhat above-average with respect to local content requirements, but these requirements apparently exist in most of the major manufacturing industries.

These data do not measure differences in the magnitude of performance requirements among industries and sectors, nor do they provide any basis for evaluating the relative impact of such national policies on U.S. investment, trade and employment. They do suggest, however, that such policies are not unique to developing countries and certainly are not unique to the motor vehicle industry. Consequently, it appears desirable to consider all aspects of these trade and investment-related issues wherever they occur and not simply to focus on sector-specific policies in certain countries.

Trade and investment-related policies obviously may cause distortions in international trade and investment flows, but far too little is known about the scope of these policies and their actual impact on the international economy. In the absence of comprehensive information and analysis of these questions, the conclusion offered by some commentators that such requirements exercise a pervasive influence on international investment patterns and substantially distort international flows of trade and capital is unwarranted. Performance requirements together with other import substitution policies may lead in the long run to the creation of internationally competitive industries. In these cases, the cost of temporary distortions in international trade and investment flows may be justified by long run improvements in international efficiency and welfare. In other cases, there may not be much chance for eventual international competitiveness, and these temporary distortions may have doubtful justification. Consequently, we are pleased that U.S. international economic policymakers recognize the limited state of knowledge of these subjects and have urged international fact-finding and discussion through the GATT Secretariat and the OECD Committee on International Investment and Multinational Enterprises (CIME) as the first step in developing U.S. policy alternatives.

MOTOR VEHICLE SECTOR

Although the motor vehicle sector is not unique in being the object of national development policies around the world, the industry does play a vital role in many national economies and for this reason it probably has felt the effects of such policies earlier than many other manufacturing sectors. Consequently, we are happy to share the experience of our member companies with these policies in the interest of contributing to better understanding of the issues and policy options.

Our companies' international experience causes us to disagree with the conventional wisdom of the current discussion that performance requirements and other import substitution industrialization policies are universally misguided attempts (1) to shape economic objectives through government fiat and (2) to circumvent internationally accepted rules against discriminatory trade barriers. The success of some countries in attracting the required investment levels for their import substitution strategies seems to confirm the soundness of their import substitution approach. In these cases, the creation of an internationally competitive manufacturing sector is a viable long run objective that may well be worth the temporary costs incurred. In other countries where the import substitution strategy is not considered to be viable in the long run, individual manufacturers have chosen not to participate or even to disinvest.

MVMA member companies believe that market forces rather than government policies should determine what type of products are built, where they are produced, and the prices at which they are sold. In addition to this general commitment, however, our members recognize that national or regional economic policies may call for industrial growth through planned programs for the motor vehicle and other industrial sectors. In these cases, governments and consumers generally pay a higher cost for vehicles to support the development of human resources and local infrastructure. When this approach is adopted, we recommend that governments mandate only overall objectives, allowing individual manufacturers to determine how those broad objectives should be attained. Any country desiring

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to establish a domestic motor vehicle industry also should be aware of the aforementioned costs to the economy and not merely the benefits received. An assembly manufacturing industry created through temporary import substitution and performance requirement policies may be more costly and less efficient than importing vehicles from the world market. These costs should be weighted against potential benefits that accrue to the country at large over the longer term.

Outside the United States, national policies to promote the development and growth of domestic motor vehicle industries have been present almost from the beginning in what are known today as the developed countries. The creation of a motor vehicle industry has been and continues to be a key element in the industrialization plans of many of these countries. This assignment of the motor vehicle industry to such a central role in national development is the result of the widespread belief that the creation of an automobile/truck manufacturing industry helps achieve vital economic and industrial development goals.

The specific approaches taken by individual countries in their attempts to create a domestic motor vehicle industry have varied with the circumstances of each country. In the case of Western Europe, the largest automotive market in the world outside the United States, the national policy approach of the early 1900's was mainly to limit imports through high tariffs, discriminatory taxes, and other non-tariff barriers. In most cases, foreign investment in local auto production was accepted and often encouraged. Although tariffs have been reduced in recent years, the EC's external tariff on motor vehicles today, for example, is still substantially higher than the U.S. rate structure. Most of the other policy elements continue in effect or have been augmented.

Japan today represents the third largest domestic auto market but for most of the post-war period was comparable to a developing country, following far more stringent trade and investment policies. Until 1971, tariff and taxation rates on imported vehicles were quite high and foreign investment in local motor vehicle production was excluded altogether. These policies were, for the most part, as severe as any of the policies pursued by developing countries today.

Other developed countries faced somewhat different problems than Europe and Japan in developing local motor vehicle industries. Their national markets were smaller and import limitations alone were often supplemented by other policies to encourage investment in local automotive production. Canada experimented with a duty remission program which precipitated a major trade dispute with the United States. The conflict was resolved by the negotiation of the U.S.-Canadian Automotive Products Trade Agreement which established duty-free trade between the two countries for most automotive products. In implementing the agreement, however, Canada established several performance requirements to assure the maintenance of a certain level of local automotive production and/or exports. Australia, New Zealand and South Africa initially relied upon local content requirements in combination with severe import restrictions to foster a domestic automotive industry. Over time these requirements were modified in most cases to incorporate provisions to substitute increased exports to obtain better economies of scale.

With this record before them, it is not surprising that many developing countries have chosen to make domestic automotive production a key national development objective. Typically, a developing country first will institute measures to restrict imports of fully assembled motor vehicles and offer a series of incentives that have the net effect of encouraging foreign firms to establish vehicle assembly facilities in the country. The policy measures employed to achieve these objectives include a combination of: (1) assistance to attract foreign investment plus (2) barriers that inhibit imports of fully assembled motor vehicles such as license requirements, tariffs, foreign exchange deposit requirements, and quotas.

In order that the newly established domestic industry not become a major consumer of foreign exchange for imported components, the country might next proceed to promulgate policies establishing escalating requirements for the proportion of component parts of the vehicle which must be manufactured locally. These policies are not intended principally as elements of a country's international economic policy but as vital domestic policy tools in the nation's overall approach to industrial and economic development.

Brazil and Argentina began this process in the late 1950's with an objective of essentially full substitution of domestic auto production for imports of motor vehicles and their component parts. Since then, most developing countries of any significant size have embarked on similar programs, although most have avoided complete import substitution because the cost of such motor vehicle

production in markets of relatively low volume rises disproportionately as the proportion of local content increases.

Alth ugh motor vehicles produced in a local automotive industry composed of relatively low volume vehicle assembly and selected component manufacture may be more costly than vehicles imported from the world market, some host countries do not consider this comparison to be relevant to decision-making. Instead, the decisions appear to rest on evaluations of what it would cost the country to obtain the same magnitude of benefits in jobs, production, national income, and foreign exchange by other means. Often, such other means do not appear to exist at any cost. Thus, our companies repeatedly have experienced the futility of attempting to dissuade some countries from embarking on such programs because of cost penalties. Such comparisons have been rejected as meaningless if the alternative is to give up what amounts to a fundamental element of national development policy.

Because of their impact on the domestic and international economy, countries should keep these broad performance objectives under constant review in light of their changing development needs. The governments of Australia, Chile, Peru and to some extent Argentina are illustrative of countries that found the cost of their policies too high and revised in varying degree their efforts to develop a motor vehicle industry through the use of import substitution policy tools. These four countries also illustrate the current inclination of many countries to reassess their experience with import substitution industrialization strategies. On the other hand, the past success of Japan serves as an example of a country paying the temporary costs of developing an infant industry in exchange for longer run improvements in both domestic and international efficiency and welfare.

Governments have turned increasingly to approaches that would accomplish their national goals but still avoid excessive cost penalties by encouraging greater scale production of fewer components through export programs. Japan's success in targeting export products certainly has played a role in this change, particularly in the Far East. By raising exports of certain automotive components—and also by increasing imports of other automotive components or vehicles—the same national goals can be accomplished at lower cost. This means lower domestic prices for cars and trucks than otherwise would be obtained and thus more domestic volume. It frequently also means more modern production because of the flexibility to import selectively.

As far as the Untied States is concerned, such programs may offer substantially more opportunities to export automotive components and parts than would be possible with more sweeping import substitution programs. This is true from a static analysis of the present situation as well as from a more dynamic, long run perspective that considers the expanded potential for automotive sales growth—including aftermarket parts—in the developing country. The experience of U.S. manufacturers with recent Mexican automotive policies offers supports for this proposition. It is important that these positive aspects be fully evaluated before final conclusions are made with respect to the overall trade effects of export requirements.

Very large automotive investments have been made by U.S. motor vehicle manufacturers to develop the sales potential of overseas markets. According to the benchmark survey, the assets of foreign affiliates of U.S. motor vehicle and equipment firms in 1977 amounted to more than $34 billion. The benchmark survey also indicates that U.S. motor vehicle and component firms exported more than 15½ billion in automotive goods in 1977. These same firms imported $12 billion of goods in return. These data do not include many export sales by U.S. suppliers of original equipment and aftermarket parts that do not have foreign affiliates nor do they count the $1½ billion in earnings of foreign affiliates of U.S. motor vehicle and equipment producers.

Overseas automotive investments do not occur merely because of the presence of investment incentives and performance requirements. Fundamental economic factors play an important role as well. Sourcing decisions are substantially influenced by the advantages derived from production utilizing economies of scale and from the efficiencies generated by responding to differences in manufacturing costs among national economies. Ideally, production of automotive components, whether by subsidiaries of vehicle assemblers or by independent producers, is undertaken in facilities designed to operate at the most efficient scale of production. Such production is not intended necessarily just to meet the demands of the market in which the facility is located; in planning the facility, global require-

ments for its output often are the operative factors. Thus, the integrated production of a major component, shock absorbers, in a world scale plant located in the United States is used to satisfy both the U.S. and European vehicle assembly operations of a major U.S. producer. Similar optimal scale plants are in operation or are planned by all major vehicle and component manufacturers.

Differing factor endowments among countries also produce real differences in manufacturing costs. Evaluating the various costs of raw materials, energy, labor, transportation, capital, technology, and other factors makes this decision-making process extremely complicated. Some of the more obvious conclusions from this process, for example, are that the sourcing for weight-reducing aluminum components will likely come from resource and energy abundant locations; for high volume, labor-intensive electrical and electronic components, like wiring harnesses, from labor abundant locations; and for technologically sophisticated components, like computerized engine controls or catalytic converters, from capital and technology abundant locations. Detailed cost of production computations are basic to this process.

Sourcing decisions, however, are also influenced by factors that have elements of both an economic and a non-economic nature. Companies may decide on a particular source for components to diversify their supply and thereby reduce vulnerability to supply interruptions. Such diversification can also provide greater financial security by hedging against exchange rate changes. A manufacturer with significant liabilities in a particular foreign currency may wish to offset them through establishing manufacturing facilities that generate assets in that currency.

Purely non-economic factors are also essential considerations in this process. An area of growing importance is political risk assessment—the potential of a given area for social, political and regulatory stability and its attendant impact on business operations.

And finally, the entire spectrum of governmental economic policies must be considered. These include not only specific performance requirements but also macroeconomic policies, trade policies, general and sectoral development policies, competition policies, research and development, government purchasing, manpower, and energy and natural resources policies. Not all of course may need to be addressed in each sourcing decision, but a general appreciation for the overall impact of the role of government on a potential sourcing arrangement must be factored into the decision-making process.

Thus, international trade in automotive products and the choice of location for production are the result of many complex factors, some of which are influenced by, but certainly are by no means dictated by the existence of investment incentives and performance requirements overseas.

It is also useful to place the foreign sourcing of automotive parts for U.S. manufactured vehicles into perspective. At present, well over 90 percent of the value of the fleet of U.S. and Canadian manufactured vehicles is procured from sources in these two countries—mainly in the United States. While the impact of foreign incentives and performance practices on sourcing of automotive parts for U.S. manufactured vehicles should not be ignored, the competitive strength and vitality of U.S. automotive producers seems likely to have far more impact on U.S. economic and employment prospects than will the overall effect of the industry's response to trade and investment-related policies.

CONSIDERATION FOR UNITED STATES POLICY

The United States Government has placed the issue of trade-related investment performance requirements on its trade policy agenda. Recognizing the absence of analytical work on the impact of these foreign policies on the U.S. economy, the initial step quite properly has been to request background studies on the subject from the GATT Secretariat and the OECD. We are supportive of these international fact-finding and analytical efforts. As more is learned about the impact of these policies and practices, an international consensus may develop on the need for new international rules. Indeed, the close relationship between the domestic development policies of so many countries and investment and trade-related practices requires such a consensus before attempting to alter these practices. Thus, we support broadly based international approaches to these issues. The issue of foreign performance requirements is clearly not an automotive or developing country issue. Rather it is multilateral and multi-product in scope.

With respect to the motor vehicle sector, we urge that U.S. policymakers recognize that investment and trade-related practices almost always are directly tied to domestic policy goals considered to be vital by most countries overseas.

Because of this relationship, these practices are deeply imbedded and politically sensitive. Although the form of some foreign practices has become more sophisticated in recent years, the objectives they seek to accomplish are neither new nor novel.

Furthermore, the United States does not have a monopoly on motor vehicle producers willing and able to adapt their overseas operations to accommodate the national priorities of our trading partners. And, in the few cases where automotive performance requirements have been liberalized—for example, in Chile, Peru, Singapore, and to some extent in Argentina—the gains from increased passenger car trade have not accrued to U.S. exporters.

In the absence of a multilateral consensus on how to address performance requirements, MVMA recognizes that the issue might occasionally manifest itself in a bilateral sector-specific fashion. In these instances, each case should be evaluated by the U.S. Government with a view not only of assessing the nature of the foreign automotive practice at issue and its real effects, but equally important, of the impact of the practice and the proposed U.S. policy response on the overall international competitiveness of U.S. industry. Analysis should not focus on domestic production and employment considerations alone. Moreover, full consideration should be given to the risk that, if the United States attempts, but then fails, to induce individual countries to lower performance requirements, subsequent bilateral trade tensions might jeopardize the international competitive position of the U.S. auto industry and other vital sectors of the U.S. economy.

CONCLUSION

It is our hope that these comments have contributed to the public discussion of the issue of foreign performance requirements and U.S. policy. MVMA is supportive of the general view that performance requirements may cause distortions in international trade and investment flows. Where an underlying economic potential exists, however, global welfare and efficiency may well be enhanced in the long run as a result of temporary policies that create short-term distortions in trade and investment flows. Because of this uncertainty over the significance of the trade-related performance requirements issue, we believe that much remains to be learned before the actual international or United States impact can be assessed.

EXHIBIT I

PERCENT OF U.S.-OWNED OVERSEAS AFFILIATES AFFECTED BY TRADE-RELATED INDUSTRIAL POLICIES BY COUNTRY

	Developed (OECD) countries				
	Canada	Europe	Japan	Australia/other	Total
Type of industrial policy:					
Tax	14	20	8	34	19
Tariff	5	4	3	14	5
Subsidies	6	14	1	10	11
Export minimum	Negligible	1	0	1	1
Import limit	1	1	1	4	1
Local content	1	1	1	2	1
Local labor	2	4	2	3	3
Other	4	5	2	10	5
Number of affiliates (thousands)	3.3	9.9	0.9	1.5	15.6
	Developing countries				
	Latin America	Africa	Middle East	Asia Pacific	Total
Type of industrial policy:					
Tax	24	15	19	20	22
Tariff	15	15	12	13	14
Subsidies	5	2	7	3	5
Export minimum	2	1	4	5	3
Import limit	5	7	2	[1] 6	[1] 5
Local content	6	4	3	[1] 5	[1] 6
Local labor	20	25	13	11	18
Other	5	6	6	5	5
Number of affiliates (thousands)	4.8	0.7	0.5	1.6	7.6

[1] Partially estimated.

Source: "U.S. Direct Investment Abroad, 1977," U.S. Department of Commerce, April 1981.

EXHIBIT II

PERCENT OF U.S.-OWNED OVERSEAS AFFILIATES AFFECTED BY TRADE-RELATED INDUSTRIAL POLICIES BY INDUSTRY

	Major industrial sectors					
	Mining	Petroleum	Trade/ finance	Service/ other	Manufac- turing	Total
Type of industrial policy:						
Tax	24	13	11	11	31	20
Tariff	12	8	3	3	14	8
Subsidies	5	5	3	3	16	9
Export minimum	3	5	(1)	(1)	3	2
Import limit	3	2	1	1	4	2
Local content	4	3	1	1	4	3
Local labor	15	13	5	6	10	8
Other	8	4	2	2	9	5
Number of affiliates (thousands)	0.3	1.9	8.1	3.6	9.7	23.6

	Selected manufacturing sectors					
	Electrical/ electronic	Transporta- tion equip- ment	Food products	Chemicals	Metal fab- ricating	Non- electrical machinery
Type of industrial policy:						
Tax	37	34	35	33	31	28
Tariff	21	18	13	16	11	11
Subsidies	18	16	16	16	18	15
Export minimum	5	5	2	2	2	3
Import limits	4	6	5	4	5	4
Local content	5	13	4	3	5	5
Local labor	13	12	12	10	9	7
Other	11	11	7	9	8	10
Number of affiliates (thousands)	0.5	1.0	0.8	2.3	1.1	1.3

[1] Negligible.

Source: "U.S. Direct Investment Abroad, 1977," U.S. Department of Commerce, April 1981.

Statement of the International Economic Policy Association, Washington, D.C.

INVESTMENT RECIPROCITY: AN OLD WORD FOR A NEW ISSUE

Background

The Reciprocal Trade Agreements program was based on the Trade Agreements Act of June 12, 1934, which empowered the President to enter into trade agreements through reciprocal adjustment of trade barriers. After the great depression and in reaction to the protectionist Smoot-Hawley Act, the general objectives of the trade agreements program was to substitute economic cooperation for economic warfare in our relations with foreign countries. The idea of direct negotiations with other countries for the reduction of excessive barriers standing in the way of foreign trade was considered more practical than the immediate revision of U.S. tariffs alone. To follow up on the trade agreements program and have the fullest involvement on the part of interested persons, including businesses in the United States, Executive Order 6750 issued June 27, 1934, under Section 4 of the Trade Agreements Act established the Committee for Reciprocity Information. The issue of reciprocity in the trade area, including the trade definitions of reciprocal concessions or reciprocal trade, has been understood since 1934 to mean the exchange of roughly equal or equivalent concessions between countries—but with no implication that the concession would be exclusive to one specific country. Indeed, the post-World War II trade agreements have generally been made under GATT auspices on a multilateral, most-favored-nation basis.

As trade and commerce increased between nations over the decades, an important component, first for the United States and now for other major industrialized and newly industrializing countries, is direct investment opportunities. The free flow of investments is part of the seamless web of international commerce, and to encumber one will jeopardize the other.

The U.S. stake

The U.S. private sector made direct investment outflows from 1948 through 1980 amounting to $81.5 billion—and has received back on those investments $231.1 billion in earnings for a net gain to the balance of payments of $149.6 billion. In addition, previous studies by the U.S. Department of Commerce showed that up to one-quarter of our exports were to foreign affiliates of U.S. corporations abroad. The newest benchmark survey completed for the year 1977 now shows that 34 percent of U.S. exports are shipped to U.S. nonbanking affiliates abroad with 27 percent coming directly from U.S. parents here in America. Thus, in 1980, of the total U.S. merchandise exports of $221.8 billion, $75.4 billion were to U.S. subsidiaries or affiliates abroad, and $59.9 billion were directly from U.S. parents here in the United States.[1] Domestic employment by U.S. corporations has been shown to increase more in those industries heavily involved in foreign investment and less in those with the fewest subsidiaries abroad.[2] In fact, of the 104 firms recently surveyed by Business International, those with the most foreign investment increased their net U.S. employment by 21.3 percent and those with the least by only 7.5 percent, thus confirming the previous study of the Center for Multinational Studies.[3] Therefore, a reduction in U.S. investments abroad would reduce U.S. exports and cause a slowdown in the increase of employment opportunities at home.

Furthermore, U.S. majority-owned foreign affiliates produce for local or third country markets in close proximity to their foreign operations. In 1977, the last year for which detailed statistics are available, total sales of majority-owned foreign affiliates of U.S. corporations equalled $507 billion. Of that amount, $413.4 billion was in local markets or in exports to other foreign countries. Excluding petroleum, imports from the mining industry, and transportation equipment subject to the special U.S. Canadian automotive agreement, only $13.3 billion (2.6 percent) flowed back to the United States.[4] A diminution in U.S. investments abroad would mean that a growing proportion of this $413 billion worth of sales would be lost; and it would be unreasonable to assume that direct exports from the United States could make up the magnitude involved. In addition, the chain of a more secure raw materials supply for U.S. industry would be weakened with more foreign-owned links.

Another growing problem concerning host country treatment of U.S. investments concerns performance requirements. Generally, these are requirements placed on the investor by the host country to the benefit of their own economy, which sometimes harm trading partners. They include import limiting, export expanding, and other requirements on the operations of foreign investors. A 1981 study has found that "The incidence of trade distorting performance requirements among the world's major host countries for direct investment affects a significant portion of U.S. foreign trade and is likely to be related to adverse trends in both imports and exports of the United States.[5]

These problems strike at the heart of international commerce, and verify that trade and investment cannot be separated as different issues. In fact, the product cycle model of investment behavior identified by the Harvard Business School studies shows the inter-relationship between them.[6] Those investigations showed that U.S.-controlled enterprises first generate new products at home and then introduce them to foreign markets through exports. When their export position is threatened because of barriers, new foreign competition or growth beyond the point where it can be serviced from home, companies establish overseas subsidiaries to continue their sales. Soon thereafter local competitors develop, which reduces the technological advantage U.S. producers once held in the product. As U.S. companies are restricted from investing abroad, they develop economic inefficiencies and their comparative advantage is lessened. In future years there will be reverse import competition back to the United States from foreign firms which will themselves own the production given up by U.S. companies overseas.

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[1] Survey of Current Business, U.S. Department of Commerce, April 1981, p. 85.

[2] "U.S. Multinational Investment in Manufacturing and Domestic Economic Performance," by Robert G. Hawkins, Occasional Paper No. 1, Center for Multinational Studies, Washington, D.C., 1972.

[3] The Effects of U.S. Corporate Foreign Investment, 1970–79, Business International, New York, N.Y., July 1981.

[4] U.S. Direct Investment Abroad for 1977, U.S. Department of Commerce, Washington, D.C., April 1981. (Table III, H1, H2, H4, pp. 318, 319, 321.)

[5] Performance Requirements. A Study of the Incidence and Impact of Trade-Related Performance Requirements, and an Analysis of International Law, Labor Industry Coalition for International Trade, March 1981, p. 17.

[6] See, e.g., Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises, Basic Books, New York, 1971.

Thus, restrictions on our foreign investments by other nations, or even those imposed by our own government on private investments abroad—while the United States remains open and does not encumber foreign investment opportunities here—restrictively affect world trade. Over time, this will have an adverse effect on the U.S. balance of payments and the American ability to compete in the world based on the traditional principles of international trade. A free flow of capital, as well as goods, is necessary to maintain a balanced world trading system.

Current controversies

These issues have become the subject of much controversy since the Canadian government under its new National Energy Policy apparently intends to nationalize energy companies operating there. Given the Foreign Investment Review Act, which requires that a notice of every proposed or actual investment be submitted to the Foreign Investment Review Agency, there are fears that the nationalization policy will broaden into other industrial areas. The Canadian moves have highlighted these investment questions, and congressional concern has now turned toward this issue with calls for "reciprocity." A House Energy and Commerce Subcommittee unanimously approved a bill in July that bans foreign firms from acquiring U.S. concerns through foreign borrowings. This would make foreign investors in the United States subject to the 50-percent margin requirement imposed on U.S. companies. In addition, a House Interior Subcommittee has held hearings on legislation that would impose a temporary moratorium on foreign takeovers of U.S. companies with Federal mineral leases, including oil, gas and coal. There was a similar bill pending before the House Energy and Commerce Committee directed only at Canadian takeovers of U.S. energy resources. Throughout all of these hearings the call has been heard for reciprocal treatment of foreign investments in the United States.

Only a few pieces of U.S. legislation now contain the authority for reciprocal action against the policies of another country which affect U.S. interests. The Mineral Leasing Act allows the Administration to forbid exploration on Federal lands by foreign companies whose country does not allow U.S. firms equal access. There is a provision of the U.S. Tax Code, Section 896(a–c), which allows the President to take retaliatory action by increasing or making modifications in the tax on foreign companies operating in the United States when U.S. companies abroad are not given reciprocal treatment. Section 301 of the Trade Act of 1974, as amended, allows the President to withdraw trade concessions or impose fees or restrictions on any foreign country that engages in unfair trade practices or encumbers U.S. commerce. But such action is taken at the behest of the injured party and for trade problems rather than investments. Our many regulatory agencies which have the opportunity to review many business activities are not empowered generally to consider reciprocity.

At the present time, for instance, the FCC and the ICC are not required to consider in any rule, regulation or decision the issue of reciprocity. In general, they do not have to consider reciprocity, and they are not required to consider the degree to which any action they take in the regulatory field promotes reciprocity in international trade. As an example, a foreign company could apply to the FCC for authority to operate in areas such as cable TV, while American companies are restricted in their ability to do the same thing in the foreign market. However, even though there is no mandate in the ICC charter to consider reciprocity, the Departments of State, Commerce, and Transportation have intervened in a pending case (M.C. 141313(1), July 23, 1979) where a Mexican company has sought to offer motor carrier services in the United States. These departments oppose the filing on the ground that Mexico does not offer reciprocity for U.S. carriers to operate there. As competition grows to attract investments these issues between nations will become more controversial.

Possible remedies

In the light of the foregoing, what should the United States do?

(1) The American government could retain the present policy of generally advocating reciprocity and nondiscriminatory national treatment. It could rely mainly on the OECD investment package and the OECD's Committee on Investment and Multinational Enterprises (CIME) with bilateral consultation as appropriate, while refraining from measures to deny certain kinds of access to the U.S. market to investors from foreign countries which do not themselves give reciprocal treatment to U.S. firms. This policy, in essence, amounts to "jawboning"; and it has not been notably successful, given the increased instances of

exceptions to national treatment, nonreciprocity, and in particular, performance requirements for foreign investors which distort international trade.

(2) The United States could adopt a strict "tit for tat" attitude of retaliating for lack of reciprocity in all cases—in effect denying the right of foreigners to do business in the U.S. market unless certain conditions have been met in their own treatment of foreign investment. However, given the wide diversity in national situations, the growth of government intervention in trade and investment matters, and important political, security, and economic relationships, this course of action might be perceived as "overkill," especially if its operation was automatic. For example, countries differ widely on which sectors are considered sensitive from a security standpoint, e.g., telecommunications, or economically, e.g., banking. Moreover, retaliation by other countries for actions which they might consider discriminatory could adversely affect U.S. foreign direct investment which, as noted above, is important to both the balance of payments and to the ability of U.S. firms to open up foreign markets.

(3) The U.S. Government could develop a new policy which would more aggressively seek progress toward an open world economy by calling for stricter reciprocity and, on a selective basis, providing mechanisms which will give other countries incentives to give greater national treatment in their own economies. The ground rules should be stated "up front" with an open-door policy as the objective and with a rebuttable presumption that a foreign nation currently affords U.S. companies nondiscriminatory, reciprocal treatment. If, however, it is shown that there is a persistent practice of nonreciprocity and nonnational treatment, then there should be a policy review mechanism governing the investments of that foreign country's nationals in the United States.

This is the course which we recommend. It will require, first, a new policy on investment; secondly, a mechanism to implement it selectively and sensitively; thirdly, procedures for multilateral and bilateral consultation to make known to our trade and investment partners the new priorities attached to effective reciprocity and national treatment; and fourth, a series of detailed implementing measures.

The policy

The present policy is presumably still that published by the Carter administration on July 6, 1977, as a statement on "U.S. Government Policy on Direct International Investment." That policy, in essence, is one of neutrality—"to neither promote nor discourage inward or outward investment flows or activities." One of the four premises on which that policy is based is that, "there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest," while another is that "unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments with adverse effects on the U.S. economy and U.S. foreign policy." (These assumptions need to be reviewed in the light of current circumstances.)

There can be little quarrel with the other premises, namely that "international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces." And that "the United States has an important interest in seeking to assure that established investors receive equitable and nondiscriminatory treatment from host governments."

We believe, however, that the emphasis in a new statement should be shifted toward a more positive stance: (a) welcoming foreign investment, subject to a more active monitoring system and continuation of prohibition or regulation of investment in certain sensitive security-related sectors—which should probably now include energy; (b) indicating that the U.S. Government intends to seek greater reciprocity for its investors abroad, in addition to assuring equitable and nondiscriminatory treatment; (c) noting that performance requirements which adversely distort international trade patterns, such as by requiring specific export targets to be met as a condition, will be taken into account under the heading of reciprocity, and (d) requiring that all regulatory agencies consider reciprocity in granting authority or regulating foreign firms operating here. The new policy statement should also accord more recognition to the benefits of open, international, two-way, direct and portfolio investment to both host and home

countries. The Administration's efforts to increase the private sector role in development financing should also be reflected here.

The mechanism

Although there are presently interagency committees which review investment matters, including the Committee on Foreign Investments, established in 1976 by President Ford, there needs to be a more effective and centralized coordination at the White House level that can guide policy with the voice of the Administration, i.e., the President. This could be a revived Council on International Economic Policy—which could be chaired by the U.S. Trade Representative in his capacity as the senior Presidential advisor on international trade and investment. Reorganization Plan No. 3 of 1979, redesigning the Special Representative for Trade Negotiations as the United States Trade Representative, vested in him the authority "for developing and for coordinating the implementation of, U.S. international trade policy, including commodity matters and, to the extent they are related to international trade policy, direct investment matters." [7]

In any case, whatever the bureaucratic structure and procedures, high-level determinations will have to be made as to when and how to apply specific measures against countries failing to grant U.S. firms effective reciprocity. Considering the foreign policy ramifications, it is obvious that the State Department will have to be closely involved, as will the Departments of Commerce and Treasury and the Executive Office. However, one individual, the U.S.T.R. must be responsible for taking the lead.

An important part of the overall mechanism should be an industry liaison office where American business can come on a centralized, "one-stop shopping" basis to bring forward complaints and information in cases where they believe they are not being treated in accordance with the standards the United States generally accords to other nationals in this country. This also applies to service industries, as well as manufacturing since the former are a growing portion of our international commerce representing a net $35 billion surplus for our balance of payments in 1980.

International consultation

In order to mitigate the possibility of escalatory, retaliatory steps which could lead to investment "wars," it is important that the multilateral consultative mechanisms available, for example, in the OECD for the industrial countries, be utilized to the maximum. But since many of the most serious offending countries are in the developing category, bilateral mechanisms should be established as well. Ideally, these would come under the umbrella of the Bilateral Investment Treaty series which the United States is now beginning to negotiate (e.g., with Egypt) and should provide for specific consultation in cases of investment disputes.

An effort must be made to explain and clarify the policy and to give the appropriate reassurances, both by public statements by senior U.S. officials and through diplomatic channels. The International Trade Administration of the Department of Commerce and its Foreign Commercial Service can also be of considerable assistance in this regard.

Implementation

Although there are one or two isolated cases where U.S. administrative agencies are mandated to consider questions of reciprocity in granting licenses, clearances, etc., to foreign investors, these are the exception rather than the rule. A new statute (possibly an amendment to the Administrative Procedures Act), or a series of amendments to other acts, could make reciprocity a requirement covering a much wider range of administrative and regulatory agencies, including the Securities and Exchange Commission. (Much direct foreign investment activity involves publicly held firms and hence SEC clearance and filing procedures.) Reciprocity and national treatment should be considered among the many factors weighed by these agencies but the U.S.T.R. should be given the specific authority to become a party to any proceeding and give the government's position when, through the reporting mechanism, there appears to be a serious divergence from what the United States expects in return for its own open access. Private parties should be given standing in any legal review where such party has been affected by the denial of reciprocity by host-country governments.

[7] Reorganization Plan No. 3, September 25, 1979, Section 1(b)(1).

The United States has never had a formal foreign investment review agency with authority to deny access to our shores by foreign business concerns. *We do not propose the adoption of one here.* However, there are instances where foreign investment here would not be subject to regulatory agency review or SEC approval as when a foreign company buys a portion of a U.S. company. In these cases and where, through U.S.T.R. review, the home country of the investor has been found to practice a continuing pattern of non-national and nonreciprocal treatment of U.S. investors, then the U.S.T.R. should be given statutory authority to intercede in the foreign company's open access to our market. This could, for example, take the form of intervening at the Justice Department and seeking an extensive antitrust review. Even without the specific legislative mandate. as in the case of corporate mergers under the Antitrust Improvements Act of 1976 (P.L. 94–435), the Justice Department has such de facto power now, if it initiates a review of its own. But the U.S.T.R. should have the specific authority to request Justice to start such a review where nonreciprocity and non-national treatment are involved. This technical but not unimportant review power can influence foreign behavior. The same principle would apply to SEC and other regulatory reviews.

Since individual States are increasingly active in attracting foreign investment, tighter liaison needs to be established with the Department of Commerce so that state licensing and franchising decisions can have more timely and comprehensive guidance on the questions of national interests involved. States should be encouraged to have their own administrative agencies take into account such national reciprocity factors in their decisions involving foreign investments.[8]

The establishment of such a policy, mechanism, consultation and implementation would, we believe, have a strong deterrent effect against countries which are themselves moving even further away from reciprocity and national treatment and provide an effective bargaining counter for diplomatic consultations. In a hypothetical case, the system might work as follows. An American company, on being denied permission to do business in a foreign country for discriminatory reasons, might bring a complaint or notify the industry liaison office. Upon evaluation, the policy review mechanism might decide that the incident in question was part of a broader pattern of policies by that country which warranted counteraction. Diplomatic consultations would then be held, and if no satisfactory solution was forthcoming, opportunities would be sought to apply a "nonreciprocity objection" to applicants from that country in the United States. Thus, in an SEC review or another regulatory agency license application, the U.S.T.R. would intervene in the proceeding to make the case for denial on reciprocity grounds. Alternatively, the U.S.T.R. would formally request an antitrust review by the Justice Department where the opportunity to intercede before a regulatory agency does not exist.

It is, of course, a central part of the policy objective that the reasons for such objection be clearly expressed, not only to the individual applicants but to their governments. In cases of a developing country which might have little or no investment activity of its own in the United States, but which, through performance requirements or otherwise, was distorting trade or treating investments other than in accordance with international law, the U.S. Government should make known its objections to prospective American investors as well as to the other home-country government. While these advisory comments would not be of a binding character, the official identification of the objectionable practice would have some deterrent effect.

In extreme cases of expropriation without compensation, the provisions of the Hickenlooper amendment on foreign aid (P.L. 87–195; Section 620(e)(1)) and the Gonzalez amendment on multilateral financial institutions (See P.L. 92–246; P.L. 92–245) are supposed to be automatically utilized under current law. Where taxes are concerned, there already exists a provision entitling the President to change the tax treatment of foreign firms where there is a lack of reciprocity, and the U.S.T.R. should urge the President to use this authority where it is warranted. Reciprocity could also enter into any decisions by the U.S.T.R. to grant GSP under the Trade Act of 1974 as amended. More active involvement by our embassy in the country concerned would also be helpful; and,

[8] Under Illinois State law, for instance, the State Banking Commission must deny branch banking for those banks whose home base does not provide reciprocity. The banking sector, however, is a complex special case, given the overlapping regulations by Federal and State authorities.

with the backing of the State Department and full interdepartmental coordination, other forms of political and economic leverage could be used to achieve a phaseout of the objectionable practices. But the key must be policy and administrative means to deny an offending country unrestricted access to the U.S. market while we maintain an open policy, *without* any detailed review wherever there is no clear pattern of nonreciprocity or non-national discriminatory treatment.

In summary, the policy tools which can be used against a foreign country's investments when a serious pattern of nonreciprocity and non-national treatment is found to exist include:

Intervention in regulatory cases with a reciprocity objection;

Presidential adjustment of U.S. taxes under Section 896 of the IRC;

Requested review by the Justice Department of antitrust implications;

In the case of financial institutions, withholding of approval under the Federal Deposit Insurance Act or the Bank Holding Company Act of 1956;

Extend the waiting period of the offending country's foreign investments under the Antitrust Improvements Act of 1976, and a detailed review with a more liberal interpretation of the antitrust implications;

Adjustment of GSP in the case of LDC's;

Use of Section 301 of the Trade Act where the investment behavior is shown to have an effect on trade flows;

Use of the Federal Mineral Leasing Act to deny foreign exploration on Federal lands;

Having the U.S. representative to international financial institutions vote against loans to countries found to have systematically practiced nonreciprocity and discrimination or otherwise significantly distorted trade;

Stricter adherence to the Hickenlooper and Gonzalez amendments;

In extreme cases, use of the powers in the International Emergency Economic Powers Act (P.L. 95–223).

We be'ieve that the policies recommended here are a better approach to the accepted objective of open markets and freedom of capital flows than continued "jawboning" in a world of growing asymmetries, and that they can be carried out selectively without harming either U.S. foreign policy objectives or the interests of U.S. traders and investors abroad.

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